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Executive Office of Transportation and Construction

Transportation Privatization Task Force

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William F. Weld

Lt. Governor
A. Paul Cellucci

Secretary
Richard L. Taylor

Task Force Chairman
John P. Merrill

December 1991

922/202

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31 December 1991

Mr. Richard L. Taylor
Secretary
Executive Officer of Transportation and Construction
Commonwealth of Massachusetts
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Dear Secretary Taylor:

Enclosed is the final report of the Transportation Privatization Task Force. The Task Force was formed last May at your request to advise you on opportunities to improve the efficiency and/or effectiveness of the transportation sector of the Commonwealth through the use of various kinds of privatization measures.

Given the scope and complexity of the subject, it was necessary to organize the Task Force into subcommittees, each focusing on a specific element of the transportation sector. The recommendations contained in the report are those formulated by the subcommittees, and do not necessarily represent a perfect consensus of either the Task Force as a whole, or even of each and every subcommittee member. Obviously, with a subject of this scope and complexity, unanimity on all points was not feasible. Nevertheless, I think it is fair to say that the Task Force as a whole supports the main thrust of these recommendations, as well as the overall conclusion that there are, indeed, significant opportunities for important new initiatives in the transportation sector.

A lot of time and effort went into the Task Force's undertaking. I am sure you will share with me a strong sense of gratitude toward the Task Force members who contributed their time and the benefit of their experience.

All of us who worked on this project will feel amply rewarded if you are able to use our recommendations to develop important new privatization initiatives that will benefit the Commonwealth.

Sincerely,

John P. Merrill, Jr.
Chairman, Transportation Privatization Task Force

JPM:jms

TRANSPORTATION PRIVATIZATION TASK FORCE

INTERNAL REVIEW DRAFT

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EXECUTIVE SUMMARY

In May, 1991, the Executive Office of Transportation and Construction formed the Transportation Privatization Task Force. The mission of the Task Force was to investigate how privatization might be applied to the agencies with transportation responsibilities. The goal was to prepare a set of recommendations to Transportation Secretary Richard Taylor. The Task Force recommends that the Administration file legislation to permit private toll roads, that the MBTA should privatize more transportation services and that the DPW determine its costs for various services and review the management structure necessary for efficient service delivery. The Task Force also notes that Logan Airport offers opportunities for component privatization and suggests the establishment of an Advisory Committee on Privatization to assist in realizing those opportunities.

The Task Force consists of engineers, lawyers, accountants, transportation experts and academics. They met as a task force three times and then divided into subcommittees that were agency specific in their focus. The subcommittees have met on a regular basis for the last six months and have analyzed the operations of the Department of Public Works, the Massachusetts Bay Transportation Authority and Logan Airport for privatization opportunities. Due to other initiatives, an analysis of the Massachusetts Turnpike Authority was not conducted.

This report outlines some of the general suggestions and highlights some project recommendations from the subcommittees. The reports include a range of privatization initiatives, from the outright sale of multi-million dollar state assets to small projects with nominal value. Following the executive summary are the reports from each subcommittee.

What was clear at the outset of the process was the need to define privatization. The task force discovered that the scope of definitions is as broad as the opportunities to privatize. From a theoretical standpoint, privatization means the sale of state assets or the procurement of goods or services through a competitive bidding process from the private sector. The good or service must be narrowly defined, there must be more than one vendor who can supply the good or service, it must be competitively procured, there must be a way to measure performance and the agency must have the right to terminate the contract in the event of non-performance. The Task Force also believes that the specifications must be more goal oriented to allow the private sector more latitude in meeting the agency's procurement objective. In general, the public sector procures many raw materials, finished goods and numerous services through a competitive process. The agencies have in-house procedures for determining whether or not the agency should buy from the private sector. The criteria used to evaluate whether to "make or buy" includes such factors as whether the agency has the equipment to perform the task, whether the agency has the expertise, whether the task is long or short term and whether the agency believes it can provide the good or service cheaper and with higher quality. For capital construction projects, which include new highways, bridges or transit facilities, the agencies, as a matter of course, competitively bid as the private sector has the equipment and expertise for such short-term projects.

The sale of state assets is a form of privatization. The Department of Public Works is the largest landowner in the Commonwealth and the MBTA also has significant real estate assets. Selling or leasing underutilized property to the private sector could raise significant revenue. The Task Force believes that the current real estate market reduces the potential

for maximizing revenues. With regard to revenues, the Asset Management Board regulations and procedures are preferred by the Task Force for the disposal of state property. The AMB regulations permit the agency disposing of the property to retain up to 50% of the revenue. Previously, all the revenue was returned to the General Fund, which gave the agency disposing of the property little or no incentive to dispose of the asset or maximize revenue.

For longer term maintenance and operations activities, the picture presented to the subcommittees was decidedly mixed. At the DPW, highway maintenance services such as snow plowing, catch basin cleaning, fence repair, mowing, street sweeping, signage and litter pickup are provided by both the Department and competitively procured from the private sector. The Task Force believes that additional privatization at the DPW is possible, but that a more substantive look at the DPW's management structure is required first. The subcommittee heard from members who believed that the DPW's structural complexity prevented the efficient delivery of services from either the public or private sectors and that this issue must be addressed first.

The Task Force learned that there are opportunities to involve the private sector at the DPW but in many cases the agency has elected to continue to provide the service themselves. Costs for identical services may be different at each of the eight DPW Districts and it is not apparent why some districts choose to provide services with DPW personnel and some contract for the services. What is apparent is that the DPW must design and implement a performance management system to evaluate whether or not services are being provided at the most cost efficient manner by either the public or the private sector. In order to evaluate the costs of providing the services by each method, it is

recommended that the DPW solicit a consulting firm to provide a database from which the decision as to whether to keep the service in-house or contract out can be made.

At the MBTA, the commuter rail system operator is Amtrak and Boston Harbor Commuter Service provides commuter boat service, to name just two examples of privatization. In the case of commuter rail, the equipment is provided by the MBTA while the commuter boat operator provides the boats. "The Ride" is also privately operated using "T" equipment. The capital required to provide private transportation services varies according to the agency's policies on capitalization in contracting. As demonstrated by the commuter rail contract, the agency can provide the equipment, thereby reducing the capital requirements of the potential vendor. The Task Force believes that if the capital equipment is provided by the agency, thereby lowering the cost of entry, it is likely that more bids will be received which improves the likelihood of a lower price.

At the MBTA, while much of the transportation services are provided by MBTA personnel, 19% of the transportation services delivered are provided by the private sector. Privatization opportunities at the MBTA include the private development of commuter parking facilities, the transfer of responsibilities to operate major transit stations to the private sector, tax increment financing for use in conjunction with the construction of the South Boston Piers Transitway and contracting for bus service. The Task Force believes that additional competitive procurement of bus service can be achieved immediately with the recent retirement of a large percentage of the workforce and the existence of a transportation procurement system that could contract for additional services immediately.

Section 13C of the Urban Mass Transit enabling legislation prohibits the laying off of public transportation workers and their replacement with private labor. The recent retirement of over 12% of the MBTA workforce provides an excellent opportunity to privatize transportation functions and stay within Section 13C regulations. The cost to put an MBTA bus on the road is almost $80.00 per hour. In cities where bus service is procured from the private sector, significant savings have been realized as private operators have submitted bids in the $50 to $60 per hour range. The savings to the MBTA could be in the millions, without any loss of service.

Throughout the country there are efforts underway to introduce private capital into the building, maintenance and operations of limited access highways. After much examination, the Task Force believes that privatization of highways should be available as another tool for providing transportation infrastructure. Key to a credible program is the adoption of a statutory and regulatory framework that serves two functions - the protection of the public interest and the encouragement of infrastructure entrepreneurs through a process that is fair, speedy and allows a fair rate of return commensurate with the risks they assume. The subcommittee has relied on statutes in Virginia and California for guidance and has designed a framework that establishes a mechanism for the creation and operation of privatized tolled roadway projects. Such projects can be existing or new highways, bridges, tunnels and/or ancillary facilities. The Task Force recommends that the Administration file the suggested legislative package during the next session. The Task Force also recommends that the framework be used, where appropriate, to permit both existing and new mass transit projects to be considered for privatization.

The Aviation Subcommittee focused on privatization opportunities at Logan Airport in two general areas. The first area is called "structural privatization" in which the ownership and/or operation of Logan Airport is taken over by private interests. The second area is called "component privatization" in which specific operating entities within the airport are similarly owned and/or operated by private interests. The Task Force feels that at the moment there are financial, legal and public policy impediments to structural privatization while opportunities for component privatization do exist. The Task Force recommends that the preliminary work done by the aviation subcommittee be used as the basis for the creation of an ongoing Advisory Committee on Massport Privatization. The Task Force recommends that component privatization of passenger and cargo terminal ownership and/or management, fueling systems and concessions be a major focus of the new Committee's preliminary mission.

In order to carry out the many recommendations of the Task Force, managers from EOTC, the DPW, Massport and the MBTA should be appointed with the power to further study and implement the recommendations. These managers, at the assistant secretary, assistant commissioner or assistant general manager level, should be given the authority to evaluate each recommendation of this report and assist in implementation.

The Task Force relied on the support and cooperation of agency staff to become familiar with agency operations and would like to thank them for their efforts.

With this report, the work of the Task Force is complete. The Task Force believes that with the opportunities identified to date, the Administration should promptly appoint knowledgeable and influential members of the agencies to further to privatization process.

In addition, the members of the Task Force are interested enough in the process to request that one year from the submission of this report, Secretary Taylor call a meeting of the membership for an update on the progress of each agency's privatization efforts.

TOLLS SUBCOMMITTEE

I. Introduction

The Tolls Subcommittee was comprised of 15 people representing virtually every significant participant in a process of privatization. Its work extended over an eight month period. The members of the Tolls Subcommittee included both commercial and individual users of transportation, developers interested in securing less congested commuting for their employees, lawyers experienced in the public regulatory process, project finance, development, environmental matters and transaction oriented corporate law, major international contractors and engineers with hands-on experience with privatization efforts, engineers familiar with Commonwealth roadways and traffic demand and consultants with special skills in navigating the complex environmental approval process. The Chairman of the Tolls Subcommittee has served as the Chief Operating Officer of the first recently privately developed toll road in the United States.

The insights of all these people serve to add credibility to the recommendations presented in this report. It is also worth noting, that to an unusual degree, task force members left ideology at the door and all worked to design a way to implement privatization in this sector in a fashion calculated to secure broad political and popular support and to add real benefit to the Commonwealth.

The Tolls Subcommittee reviewed models of privatization currently being developed in Virginia and California and evaluated the strengths and weaknesses employed in each of those states with the objective of adapting a process appropriate and workable in Massachusetts. The Tolls Subcommittee also familiarized itself with the literature in the field, consulted with outside experts and with the relevant agencies in the Commonwealth as appropriate.

The Tolls Subcommittee concluded that its most significant contribution aside from presenting the Secretary with its recommendations regarding privatization of new and existing transportation assets would be in the design of a statutory framework for the implementation of privatization of new or existing transportation assets. Over a six month period, development and modification of this framework provided a mechanism to discuss the issues involved in privatization. That framework follows the Conclusion and Recommendations of the Tolls Subcommittee in this report.

Successful implementation of privatization will require active commitment from the Commonwealth to removing roadblocks, consolidating review and convincing the infrastructure entrepreneurs who are essential to successful implementation that public regulation will be fair and prompt.

Public regulation itself is equally essential to ensure that citizens of the Commonwealth have confidence in the fairness of tolls which they are asked to pay and that the returns that private sector owners and operators receive are reasonable in light of the risks which they assume. Without prejudicing the results of this regulatory review it is worth stating the obvious that required rates of return for existing assets with predictable existing traffic will be more consistent with returns expected for public utilities than those required for new or expanded assets which have significantly higher risks for the operator.

The Tolls Subcommittee acknowledges the assistance and cooperation of EOTC, especially Assistant Secretary Thorn Mead. Douglas MacDonald of Palmer and Dodge deserves special recognition for his skillful efforts at helping to guide the Tolls Subcommittee through the complex process of designing a sound program which ought to be achievable.

II. Conclusions and Recommendations

1. Privatization opportunities exist for the development of new or expanded road, bridge and tunnel facilities and for the disposition of existing tolled facilities. Privatization cannot solve all the Commonwealth's problems. It should be available, however, as another tool

for providing transportation services to the citizens of Massachusetts without the expenditure of public funds or as a tool to increase the funds available to the Secretary and the Governor to meet critical needs of the Commonwealth.

2. The key to a credible program of privatization is the adoption of a statutory and regulatory framework which serves dual functions -- protection of the public interest and encouragement of infrastructure entrepreneurs through a privatization process which is fair, speedy and which permits investors and developers to earn a fair rate of return commensurate with the risk they assume. The full Tolls Subcommittee Report includes a blueprint of proposed legislation to implement the privatization of new and existing tolled projects. The Tolls Subcommittee has relied on statutes enacted in California and Virginia and experience in implementation in both states in developing a proposal for the Commonwealth.

3. The Secretary should endorse a privatization program and should consider seeking passage of legislation which would allow the first proposals to be considered in fiscal 1993.

4. The Commonwealth should define tolled projects to allow creative and flexible site-specific approaches including air rights, concession, cross-subsidies with mass transit or port development, etc.

5. The Tolls Subcommittee believes that implementation of an expedited coordinated MEPA and local government review process will ensure protection of important environmental values and local interests. This is important to achieve credibility of the privatization process and its promise that it can deliver results in a time sensitive manner so as not to discourage entrepreneurial energies.

6. Local governments have an important role to play in implementation of the privatization process. It is anticipated that they will realize direct financial benefits from placing new and existing tolled assets on tax rolls. Whatever the specific ownership arrangement, owners of privatized assets should be subject to local, state and federal taxes, thus representing an important potential source of new tax revenue.

7. Privatization offers significant opportunities to accelerate delivery of new or expanded transportation assets. Essential to achieving this goal is adoption of design/build approaches to procurement, utilizing techniques already used in other areas of public construction. Aggressive subcontracting requirements will ensure cost-value optimization as well as providing fair opportunities for participation by Massachusetts and/or WBE and MBE firms.

8. Privatization of new, expanded or existing facilities can be accomplished through a variety of mechanisms including ownership, lease, or public sale of shares in an existing entity.

9. Although use of eminent domain powers should remain under the control and discretion of the MDPW, once a project has been designated by the Commonwealth as consistent with the public interest and deserving of public support, the state should be authorized to utilize eminent domain on behalf of an operator of a privatized facility if private negotiations are unsuccessful in securing necessary right of way.

10. EOTC, DPW and the relevant transportation authorities should help to make the Commonwealth as open to privatization as possible through cooperation and sharing of information, existing studies, etc. to private sector developers or operators of transportation/infrastructure assets. It is essential that these agencies adopt the attitude that privatization is a positive ingredient to helping them have the resources to do their job in the best possible way.

11. The Tolls Subcommittee believes that whatever its sources (including sharing in superior operating performance), revenue accruing to the Commonwealth from privatization should

remain in the transportation sector for use as a source of subsidy for existing assets, providing a higher level of service, or providing a source of funds for the more rapid construction of transportation facilities.

12. There should be opportunities for the Commonwealth to participate in financial benefits when superior spending performance of privatization projects allows the level of return to exceed that necessary to secure private participation.

A PROPOSED LEGISLATIVE FRAMEWORK FOR PRIVATIZED HIGHWAY TRANSPORTATION PROJECTS

Purpose of the bill	To establish a mechanism for creation and operation of privatized tolled roadway projects suited to the transportation needs of the Commonwealth.
"Tolled roadway projects"	"Tolled roadway projects" can be highways, bridges, tunnels and/or ancillary facilities for motor vehicles use. A project should be flexibly defined so as to promote creative site-specific projects, including air-rights, concessions, transit, HOV facilities, etc. Projects may include new development/construction or rehabilitation of existing facilities (whether or not currently tolled) or a combination of new and old.
Participants in the process are	The Operator: Applies for and obtains a Certificate of Authority through the process described in the bill and undertakes to construct or operate a project. EOTC: Conducts the application/certification process described in the statute, determines that the project meets a public interest standard and approves (by itself or through delegated action by the DPW) its critical transportation details. Transportation Economic Regulation Agency: An independent, quasi-judicial agency which makes findings based on a developed record and with opportunity for review at the SJC. Approves the rate-of-return on investment and sets the toll rate, probably as a "cap" to permit flexibility for the Operator, and is also vested with continuing jurisdiction over future toll adjustments. Local Governments: Consult with EOTC and the applicant-operator to develop the "list of conditions" described below which governs the Operator's relationships with host communities. Interested Citizens: Participate though the MEPA process and at EOTC and Econ. Regulation Agency hearings in commenting upon and affecting the final shape of the project.

Use of regulations	The bill should be written to include the necessary principles of the privatization process, leaving many details (application requirements, etc.) to development by the involved agencies but discouraging excessive bureaucratic delay.
Powers and duties of an Operator	The Operator can be a corporation, partnership, joint venture or other form of business entity. In addition to all the usual applicable powers, the bill lists specific powers an operator may exercise when granted a Certificate, Such as to: • construct, operate and collect tolls for the project. • adopt with DPW approval regulations for use of the project, classification of tolls, safety, etc. The bill shall also place duties on the Operator: • maintenance of the project and its accessibility for public use. • contracting with appropriate state agencies for traffic and public safety enforcement, etc. • conformance with environmental protection requirements.
Opportunities for cooperation with the state.	Projects can be performed in cooperation with or as joint projects with the state. Project financial arrangements can involve "return sharing" with the state at any point in the funds flow or during the project term. Some projects may also be suitable for risk-sharing with the state.
Initiating a new project	Projects involving new or expanded facilities may be initiated by: • EOTC's public invitation for proposals for a specific project or any or all projects on a list of projects. • a prospective operator submits its own project(s) proposal to EOTC. Initiation of a project commences the certificate process described below. All steps in the EOTC and Econ. Regulation Agency process shall be governed by time deadlines on agency action such that failure to meet deadlines absent agreed-upon extensions shall be deemed to result in agency approvals.

Privatizing an existing project	Projects may be initiated by the same process used to initiate a new process: Differences between a "new project" and a privatized "existing project" may emerge at the later stage of assessing risk and return elements for projects which are up and running or have a proven revenue stream.
Applying for and obtaining a Certificate Step 1. Notice of Intent to Apply	Applicant submits its Notice of Intent to EOTC containing: • a preliminary description of the proposal project stating its transportation benefits, principal engineering and right-of-way features, and projected plan of finance. EOTC reviews and if satisfied that the proposed meets a preliminary standard ("likely public interest"), approves the submission of an application. *At this stage EOTC may exercise discretion to "open up" an applicant-proposed project to competing applicants who will be given opportunity to submit a Notice of Intent, EOTC may establish a "prequalification" process to reasonably limit the number of applicants going forward with the process.* EOTC's approving the submission of an application triggers Operator's development of the application. Steps are also taken for: • giving appropriate public and community notice of the proposed project. • appointment by EOTC and EOEA of a local government coordination/citizen advisory committee task force to work with the applicant in developing a proposed "list of local conditions" (see below) and to participate in the MEPA process. • establishing through EOTC a cross-modal coordinating review (highway/transit interaction, etc.) with other transportation agencies, if required by the nature of the project. • providing access by applicant(s) to DPW surveys, as-builts, and other available technical support.

Step 2. EOTC Tentative Designation	Applicant submits its application to EOTC containing: • a description and concept design of the proposed project and its traffic management and other transportation benefits. • preliminary plans for acquisition of right-of-way or other property interests and for connection with public roads and highways. • a proposed plan of finance including proposed toll levels and classifications, the terms of any contractual rights or obligations regarding toll revisions requested for inclusion in the certificate, etc. • a proposed Environmental Notification Form ("ENF") to commence the MEPA process. EOTC reviews the application for completeness. Once the application is deemed complete, a sixty day period runs in which EOTC conducts a public hearing and accepts or rejects the application. An accepted application receives EOTC's "Tentative Designation" which sets forth the further duties of the Applicant and EOTC in the remainder of the process. *At this stage EOTC winnows a field of competitive applicants to a single proposed operator. If the selected applicant fails to meet progress milestones set by EOTC for further steps, a redesignation may occur.* After Tentative Designation has been received the Operator is expected to file its ENF, begin the MEPA review process and commence negotiation of a Comprehensive Operating Agreement with EOTC. During this period the Operator would also perform its own major engineering efforts so as to meet the stage of engineering detail required by EOTC for final designation (see below). While these efforts are on-going, the Operator also engages in the Econ. Regulation Agency review described below. MEPA review is on-going from this point with flexible procedures approved by EOEA under "major and complicated" designation or similar rules accepted by EOEA.
Step 3. Econ. Regulation Agency Review	Based on the tentative designation, the Applicant submits an application for a rate approval order; Econ. Regulation Agency issues its rate order following a public hearing.
Step 4. EOTC Final Designation	EOTC issues Certificate of Authority including the Comprehensive Operation Agreement, the list of local conditions (see below) and incorporating the toll levels and requirements approved by Econ. Regulation Agency.

Continuing post-designation review	EOTC maintains post-designation authority re: • Operator's obtaining of permits and licenses; construction may not commence prior to receipt of a final MEPA certificate. EOTC will coordinate expedited and unified permit review whenever possible. • approval of engineering plans and construction and inspection requirements. See "Comprehensive Agreement" for conformance with DPW standards. • acceptance of the completed project. • continuing jurisdiction over maintenance, safety, expansion, level of service and other transportation operating matters.
Design and construction procedures	Applicant/Operator is authorized to use "design-build" construction and the Operator may enter into a General Contract with a contractor of its own choice. The Certificate may require that a percentage of the value of the work be awarded to subcontractors selected after public advertisement so as to provide fair opportunities for participation by Massachusetts and/or MBE/WBE firms.
Environmental review and permitting	MEPA review is required and dovetails with the applications process. The MEPA certificate from EOEA must be received by EOTC before EOTC can issue its Final Designation.
Ownership interest	Property used in the project may be held by the Operator through ownership, lease or in any other manner approved by EOTC in the Certificate.
Eminent domain arrangements	The Operator would be authorized in the Certificate to seek the state's use of eminent domain by the DPW acting on the Operator's behalf if private negotiations failed to achieve right of way acquisitions. Eminent domain would then be exercised by the DPW following Chapter 79 or Chapter 80A procedures with a special provision for the Operator to help expedite proceedings by supplying surveys, appraisals, attorneys, etc.
Powers granted to local governments	Local governments would be authorized by the bill to take various actions to facilitate the project such as granting easements, street connections, police protection, etc.
Taxes and fees	The Operator will pay applicable federal, state and local taxes and fees.

Other public interest protection	The bill would provide other public protections such as public record status of key documents; conformance with environmental laws and regulations; encouragement of conservation/air quality/SIP guarantees or initiatives; I.G.'s inspection of records relating to expenditures of public funds, if any.
Property transfers	The Asset Management Board will be authorized to transfer state lands, personal property rights in bridges and other appurtenances, and other right-of-way interests to the Operator for purposes of the project, subject to usual constitutional protections.
Tax-exempt finance	The bill will satisfy state law requirements for the Operator to access tax-exempt finance through a public issuer such as MIFA or a transportation agency if and to the extent federal tax law permits.
Protection to local governments through the "list of local conditions"	The list of local conditions would be developed by the Applicant and EOTC working through the local government coordination process. It would include matters ranging from street crossing and utilities maintenance requirements, to taxation arrangements, to "mitigation" or "host community compensation" arrangements. The approval by EOTC of the list of conditions could operate to displace, limit or modify local zoning, land use and regulatory controls in a multi-jurisdiction project to the same extent as if the project were a "state" project insofar as concerns local control.
Fees and regulations	EOTC and the Econ. Regulation Agency would be authorized to charge fees for the application process designed to cover its administrative costs, and its own technical assistance staff and consultant costs in evaluating the application.
Termination of franchise	The term of the franchise held by the Operator to collect tolls and operate the project would be set by EOTC in the Certificate. The term an be fixed or flexible depending on the Certificate. At the conclusion of the franchise (whether a fixed term or a flexible term designed to provide the Operator's designated return) all project facilities become the property of DPW or another appropriate public owner/operator designated by EOTC.
Default by the Operator	Defaults under the Certificate or any of its subsidiary agreements or incorporated DPU orders will be determined by the DPU as its own motion, or on motion by EOTC, etc., after notice and hearing.
Protection of confidential information	The bill would specify which elements of application materials or the project records would <u>not</u> be open to public inspection.

Transit Committee Report

The Transit Committee divided itself into three working groups, which focussed on financial issues, real estate issues and boat transportation issues. The Committee met several times as a whole to discuss these matters, and the working groups met individually as well. Each of the working groups prepared a report, all of which are attached.

During most of our meetings, we received reports from various staff members of the MBTA. As the reports which follow explain, all of us appreciate the time and the care which the MBTA staff members took in providing us with information and insights into the operation of the MBTA. We found the staff very willing to help, and their reports were informative. All of us were impressed with the professionalism and the pride which the MBTA staff members displayed in their work.

The reports which follow are based on a view of the process of "privatization" of transit services. To that extent, the primary focus of our view was to search for ways to induce people to limit the use of their cars, thereby easing traffic congestion as well as reducing air and noise pollution. A recent survey by the U.S. Department of Transportation found that 89% of the trips taken in the country are by car. In contrast, less than 1% of the trips taken are by transit, including boats, trains and buses. The number of miles traveled by car in 1990 was 2.1 trillion miles, and this figure is growing at the rate of 4% per year. Only by concerted effort can the number of trips taken by car be reduced.

The committee members agreed that the definition of privatization embraced much more than the simple sale of public assets to the private sector, or the assumption by private vendors of responsibility to deliver public transportation services. We agreed that privatization is a pragmatic effort to remove glaring inefficiencies in the delivery of transportation services. It seeks to provide the same service at a lower cost or a better service at the same cost.

The definition of privatization is relatively simple, but it must be considered in a context. First, "service" should be measured in terms of reliability and efficiency. Reliability means that users can depend on the services taking them from point A to point B in accordance with a preset schedule without interruption or inconvenience. Efficiency means that the amount of time to get from point A to point B should in some sense be "competitive" with the amount of time it takes to travel the same distance using alternative transportation modes.

Second, planning for the privatization of transit services will affect several different services at the same time. Sometimes, the services will work together, so that the user can take several different modes of transportation to travel efficiently and inexpensively. Other times, the services will complement each other, something which should be encouraged whenever possible.

The reports discuss quite a wide variety of issues. The Boat Transportation report, for example, comments on such issues as the need for coordinated planning strategies among different modes of transportation, the need for a framework which permits cost comparisons between modes of transportation, and the importance of designing bidding processes which invite private operators to provide services on terms which make economic sense. The Finance Committee Report comments on such issues as the need for forward funding of the MBTA budget, and suggests that private developers be used more extensively in parking facility development, that private developers be considered for the operation of all aspects of major transit stations, and that the MBTA consider installing a modern fare collection system. The Real Estate report comments on such issues as the utility of using benefit assessment districts to help finance new major capital projects, the importance of having a dedicated revenue stream for the MBTA, and the need to explore strategies for attracting private funding for capital projects.

The reports which follow include the recommendations of members of the private sector. The Committee members hope that the Executive Office of Transportation and Construction will be open to new approaches and new ideas, some of which are included in these reports. In that context, EOTC should, whenever feasible, give the private sector an opportunity to make its own suggestions as to how improved services or lower cost services may be provided before the limitations of the Request For Proposal process are imposed. In other contexts, the Commonwealth has devised a competition whereby private bidders make proposals as to how to provide a particular service. The public sector then responds with an RFP. The original bidders are then invited to amend their bids to respond to the RFP. This process is useful in giving the public sector a sense of what the marketplace is prepared to offer and what the price might be. It provides an important opportunity for the private sector to offer innovative ideas in a context where those who advance the ideas then compete for the opportunity to put them into practice.

We have included both the summary reports and the working papers for each of the subcommittees. In this way, the reader can get the fullest understanding of our views on the issues addressed.

TRANSPORTATION PRIVATIZATION TASK FORCE
TRANSIT SUBCOMMITTEE

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Commonwealth of Massachusetts

Privatization Task Force
Transit Committee

Report of the Finance Subcommittee

INTRODUCTION

Privatization

The Finance Group was charged with the assignment of working with any definition of the term "privatization" which promised to achieve cost savings without sacrificing service or safety and which took appropriate note of any "social costs" involved. In its investigations, the Finance Group focused primarily on the MBTA, since the MBTA is far and away the largest provider of non-private, non-federal transit services in the state. It did not explore more traditional, but non-private, means of generating revenue by means of dedicated revenue streams such as gasoline taxes, toll charges and the like. Some of the ideas considered, and some recommended, do not fall within the traditional scope of "finance." The Finance Group felt that, given its very broad charge, it should consider any mechanism which promised to provide increased revenue or capital, in large or small amounts, to the MBTA.

Massachusetts Bay Transit Authority

The Finance Group, in its own investigations and as part of the Transit Subcommittee, received numerous presentations from the officials of the MBTA. On many occasions, these officials were closely questioned and were asked to provide additional information. Members of the Finance Group were uniformly impressed by the professionalism, dedication and knowledge of the MBTA officials and staff whom they interviewed. The recommendations of the Finance Group are the results of efforts by individuals in the private sector, who are not transit professionals, after a short and limited review of the situation, to bring the benefit of private sector experience and, in some cases, new and different perspectives to the task of providing public transit in one of the oldest and most urbanized areas in the United States. Its recommendations are not intended as criticism. In fact, while an appraisal of the MBTA was not one of its objectives, a by-product of its deliberations could have been identification of deficiencies and failures; however, the Group did not encounter any. The Group's observations set forth in this report are no more than ideas (some of which were proposed by the MBTA itself) which appear worthy of further inquiry. Ideally, some will merit implementation.

A summary of the methods employed by the Finance Group, the people it met with and the material it examined is set forth in Appendix A.

MBTA: Budget Buster?

As has been widely reported, the state appropriation for the MBTA has grown dramatically during the past decade. However, the MBTA now provides more service, to more riders than it did a decade ago and at lower real cost.[1] Increases in cost to the state have been largely due to the increased size of the system (with commensurate increases in capital costs and debt incurred as authorized by the Legislature), a decline in federal support for transit, and a reduced share of net cost of service borne by MBTA member communities because of Proposition 2. Nonetheless, practical efforts to reduce costs and improve the efficiency of the MBTA are as necessary as ever in light of current fiscal reality.

The Finance Group noted that virtually all public transit systems in the United States are supported by a dedicated revenue stream from a regional sales or gas tax or from tolls on transportation facilities within the transit district. While consideration of such financing arrangements was beyond the scope of the responsibility of the Finance Group, it was felt that the pervasiveness of such regional funding mechanisms should be noted.

The Finance Group believes that in evaluating the true cost of the MBTA to the Commonwealth and to the MBTA Member Communities, a systematic accounting should be taken of the contributions which the transit system makes to the broader transportation and environmental needs of the metropolitan area. For example, to the extent that the cost of providing a passenger mile of service is less than the sum of the cost of providing a comparable mile of service by means of another transit mode (e.g., automobile) plus the cost of environmental controls or offsets needed to compensate for the polluting characteristics of that other transportation mode, the costs incurred by the MBTA should be discounted to account for the non-transit costs which have been avoided.

RECOMMENDATIONS

I. Forward Funding.

Substantial attention and study has been directed in recent years at the funding and assessment structure of the MBTA,

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[1] A Catalyst for Economic Growth: Funding of Public Transportation in Massachusetts (hereafter "Funding Report"). Massachusetts Bay Transportation Authority (April, 1990), pp. 3, 18-21.

including one extensive study that was required by statute.[2] It was beyond the expertise and the resources of the Finance Group members to revisit the details of this issue. Nonetheless, because of the high visibility of this financial issue, the Finance Group felt compelled to comment on it. The Finance Group notes that the study concluded that although a shift to so-called "forward-funding" of the MBTA would serve to conform the now unusual budget and appropriation structure of the MBTA more closely to that of other entities funded by the state, such a shift would not begin to save money until the year 2008, and even then would, considered alone, save only the interest costs associated with the current short term financing of the system. It would not provide a substantial solution to the financing challenges confronting the MBTA. In addition, a shift to forward funding, particularly in the absence of a dedicated revenue stream, might subject the MBTA to the political conflicts among competing interests within the appropriations process, one of the tensions which privatization is intended to remove. The Finance Group also notes that MBTA operating expenses, the portion of the MBTA budget which would be affected by a shift to forward funding has, over the past decade, grown at a rate <u>less</u> than overall state spending, while debt service, the portion of the MBTA budget which is already subject to appropriation, has grown at a rate <u>greater</u> than overall state spending.[3]

II. Transfer of Assets or Opportunities to Private Parties.

1. Private Development of Commuter Parking Facilities.

The Finance Group believes that there are several opportunities for the MBTA to transfer, by sale, lease, or other agreement, to the private sector both the opportunity and the responsibility for building and operating commuter parking facilities within the vicinity of major transit stations. While the specific bundle of rights and responsibilities to be transferred to the private sector should be tailored to each location, the Finance Group imagines that typically the MBTA would sell or ground lease a parcel of land adjacent to a major transit stop to a private developer, in return for a commitment from the developer to build, maintain, and operate a commuter parking facility of a given size on a given schedule for a given number of years. The extent to which the MBTA was to be involved in the design of the facility, the schedule of parking fees, and other details would be a matter of negotiation between the MBTA and the private developer, but the Finance Group believes that the greatest advantage to all parties would be obtained by the MBTA having as little continuing involvement with the details of operation as is compatible with its public responsibilities. The Finance Group observed that any such plans for parking garages would of course be subject to the obligation imposed on all parties by the federal and state air pollution control laws.

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[2] Funding Report, note 1, above.
[3] Funding Report, note 1, above, pp. 18-21.

While the Finance Group made no systematic survey of possible sites for such an operation, it did note that one such opportunity may exist in the area of Bunker Hill Community College. The contemplated expansion of the existing parking garage at Alewife station might also be pursued as another alternative.

The Finance Group noted that there are certain substantial hurdles to successful private development of transit facilities such as these. A private developer of such facilities could not currently have the benefit of the substantial federal funding which is available for public transit projects (e.g., 80% of a portion of the Transitway to the South Boston Piers Area will be federally funded). It is questionable whether tax-exempt funding would be available for a privately constructed project. If such a project were built entirely with privately raised capital, the cost of amortizing such an investment might require parking fees far higher than are now customary for such facilities. If ridership is sensitive to increased costs (as it appears to be), it may be difficult to reconcile the private financing of such facilities with environmental or public-policy goals of increasing ridership. One possible solution to this problem could be the establishment of a local parking authority whose sole purpose would be the financing, development, construction and management of the proposed transportation facility. Such an authority could serve as an umbrella under which a public-private partnership could develop the facilities. A more detailed evaluation of specific opportunities is required to determine the feasibility of this structure.

Despite the hurdles faced by providing these facilities in this manner, it should be noted that activities of this type serve a much broader goal of our political and transportation systems. If successfully implemented, such project would yield:

Job growth;
Faster related economic activity; and
Provide significant mitigation measures to address impacts created by such publicly funded projects as the Central Artery/Third Harbor Tunnel.

2. Transfer of the Responsibilities and Opportunities of Operating Major Transit Stations.

The Finance Group believed that, at least as an experimental program, the MBTA should consider marketing a package of rights and responsibilities for the operation of one or more of its major transit stations, to determine whether a private real estate developer or operator could create significant value within such stations. For example, the MBTA might turn over to a private party all of the operational, maintenance, fare collection, and related responsibilities for the operation of the Harvard Square, Alewife, New North Station, or Ruggles transit stations. The MBTA would retain full right

and responsibility to operate and maintain the trains, the track, and the structural features of the stations and related tunnels. The successful private bidder would be required to collect and account for all fares, and maintain, clean, police, and operate the station as an efficient transit station. Beyond those specific responsibilities, the private developer would have a free hand to utilize the space within the station for any commercial purpose it chose. This would turn over to that portion of the private sector most skilled in the development of commercial real estate the task of maximizing the use and the income obtainable from the space within major transit stations. Such private operation might not generate a profit and may require a subsidy from the MBTA, but it would provide a public benefit if the required subsidy were less than the current cost to the MBTA of operating the station.

3. Contract For Private Bus Service.

The Finance Group considered whether operating segments of the MBTA's transportation system would have positive value if operating contracts were put out for bid to the private sector. This did not seem feasible with regard to existing rapid transit lines due to current fare collection procedures and other operational requirements.

The Finance Group noted that a number of cities now provide a significant portion of their bus service via competitive contracting (i.e., bids are accepted from both public and private providers), including major cities such as San Diego and Denver. Many of these municipalities claim that substantial savings have been obtained by providing service in this manner. The Finance Group recommends that, if further study shows that the savings claimed by municipalities which use competitive contracting have in fact been achieved and that such savings would seem to apply to a municipality with the characteristics of Boston and a transit system configured like the MBTA's the MBTA be encouraged to implement competitive contracting of bus service to the extent practicable. The MBTA might initially focus on new routes or might phase in competitive contracting at some rate at or below the employee turnover rate, so as to minimize unproductive disruptions to existing labor relations.[4] By coordinating the implementation of any contracting for bus service with the increase employee attrition due to the early retirement program, the MBTA could reduce any potential liability under Section 13C of the Urban Mass Transportation Act.

The Finance Group took special notice of the anticipated results of the privatization of part of the bus service of the Denver Rapid Transit District (RTD). A 1988 statute (Senate Bill 164) required that, by November, 1989, at

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[4] The Finance Group notes that Federal law and existing labor contracts limit the flexibility of MBTA management in providing transit service through contracts with private companies.

lease 20% of the vehicle hours accrued by buses serving the Denver Rapid Transit District be contracted-out. The legislation further required that, by the end of 1990, the RTD have an audit of the privatization effort performed by an independent certified public accounting firm. This audit was prepared by KPMG Peat Marwick and submitted December 24, 1990. This report forecast that cost savings ranging from 14.9% (on an incremental cost basis) to 27.5% (on a fully allocated cost basis) could be realized over the 5-year term of the then existing contracts. However, as of the date of the audit, the privatization effort had resulted in a net cost to the RTD and the private contractors participating in the program had all incurred losses. Nonetheless, because of the predicted potential for savings, and a number of apparent similarities between the MBTA and the RTD bus systems, the Finance Group concluded that the MBTA should evaluate the efforts of Denver and other cities which have undertaken privatization initiatives so as to determine whether the savings anticipated have been achieved, and whether comparable results could be attained at the MBTA.

The Finance Group also observed that there is a significant number of privately owned buses used for morning and evening commuter runs into and out of Boston, which are largely unused during the middle of the day. Because of this existing, unused capital investment on the part of the private sector, it may be possible to identify certain bus routes within the MBTA system which would be particularly attractive to the private sector and which would generate bidders for those routes.

The Finance Group felt that a fair evaluation of the merits of contracting-out bus routes must include proper accounting of an amortized share of capital costs to the MBTA for equipment which might be idled if service is provided by private companies. Both the MBTA and private bus companies are oriented toward providing service adequate for peak demand; both currently have excess equipment for off-peak hours. If off-peak service were privately provided, it is unlikely that the MBTA could reduce its capital costs, since its bus fleet would be needed for peak demand. Thus private provision of off-peak service could result in the MBTA paying the capital costs of is own (idled) fleet as well as a share of the capital cost of the private equipment actually used. Additional study is needed to determine whether the total peak capital needs of the MBTA and the private companies could be reduced as part of any contractual arrangements.

The Finance Group noted that the MBTA currently contracts with private providers for bus service on a small number of lines.

III. Fare Collection System.

Fare collection is critical to the MBTA, since it is the sole significant non-subsidy source of revenue for the

system. The existing fare collection system is not as reliable as it could be. The MBTA recognizes the benefits of upgrading and expressed their interest installing a modern fare collection system. However, because of the size of the transit system, and the numerous collection points within it, it is estimated that a modern system would represent a capital investment of between $60 and $100 million.

The Finance Group believes that the MBTA should consider soliciting proposals from the private sector according to which a private company would install, operate and maintain a complete, modernized fare collection system, would lease it to the MBTA over the long term, and under the terms of the lease would service, maintain, and replace equipment as necessary. Such an arrangement should, to the maximum extent possible, eliminate the need for manual change-making or token sales and could maximize the distribution of passes. A modern fare collection system should result in savings to the MBTA because of increased operating efficiencies, and should increase operating revenue by reducing fare loss which results from inadequate fare collection equipment. In addition, such a system would increase ridership information and permit the MBTA to better plan its operations in response to such information. In connection with such a privately operated fare collection system, the MBTA should consider using the services of a private financial institution in place of its so-called "money room" operations.

The Finance Group took note of the fact that every ride on the MBTA is subsidized regardless of ability to pay. As the MBTA moves toward a modern, computerized fare collection system it should explore, to the extent feasible, making fares proportional to both the distance travelled and the ability of the rider to pay the actual cost of the service.

Modern fare collection equipment would also make possible "peak-pricing" -- increasing the fare at the most heavily travelled times. Some public services, such as electricity, are already priced this way, to account for the fact that service provided to cover peak demand is the most expensive to provide and should be paid for accordingly. By "peak-pricing" fares, the MBTA would also provide riders with an incentive to ride at off-peak times, thus spreading out demand, better utilizing the transit lines, reducing need for the most expensive service and thus lessening the average cost of service. If crowding of transit services were reduced, increased ridership could be expected, which in turn would reduce automobile traffic and reduce air pollution.

IV. Private Construction and Operation of Transportation Facilities.

In California, Assembly Bill 680 authorized innovative approaches to transit financing worthy of further analysis here in Massachusetts, namely, the private construction and operation

of several major transportation facilities. The first of the projects to go to bid was the Santa Ana Viaduct Express (SAVE), an 11.2 mile elevated freeway in Orange County. This project contemplates the construction of an elevated highway along the course of an existing flood control channel. The highway will be operated as a toll road by the private consortium which will construct it.

While the economic viability of any such a project would depend on its specific circumstances, the Finance Group felt that the MBTA should explore this approach in the construction of one or more of its proposed major transit projects. The Finance Group also considered that even if a selected project could not generate adequate revenue, through tolls, fares, ancillary development, or otherwise, the discipline of offering such a development to the private market could provide a scale against which comparable public projects and operations could be judged.

In requesting proposals for such projects, the MBTA should give developers the option of submitting proposals which would require subsidies from the MBTA. For example, proposals received for a given project might range from ones which require significant subsidy to others which offer to fund the development entirely out of private capital. If all proposals received required that the MBTA provide a subsidy, then a public purpose might be served in two ways. First, if the subsidy required by the private developer were less than the projected cost of public development of the same facility, a more efficient means of providing equivalent service may have been found. Second, if competitive bidding on a given project fails to produce a private developer willing to undertake the project on the strength the project revenues alone, such market evaluation of the economics of the project could serve to re-focus public debate as to the wisdom and the net benefit to be obtained from the project. Obviously, such evaluations are complex, involve environmental and other public-good considerations which are not easily valued in a private market analysis, and do not admit of simple judgments. Nonetheless, the Finance Group was of the view that such a venture into the private market, even if unsuccessful, might produce an objective and credible basis for continuing the debate over the funding, development, and operation of transit facilities in the greater Boston area.

The Finance Group understands that hurdles stand in the way of such an approach to constructing additional segments of the transit system. Chief among these is the inability of such privately funded facilities to utilize federal transportation funds. Unless the relevant federal laws are changed, transportation projects such as SAVE may only make sense only where federal funds were not available. In addition, the operational requirements of an integrated transit system such as the MBTA may limit the feasibility of a "Build, Operate, and Transfer" ("BOT") project, because of the difficulty of

integrating an independently operated transit line into the system. Nonetheless, the Finance Group believes that, to the extent compatible with federal funding, an effort to utilize the BOT approach to transit development in connection with the Old Colony Project should be explored. Even if the construction and development of the Old Colony Project is pursued in a conventional manner, the Group concluded that an effort should be made to contract out the operation of that line.

The MBTA could also attempt a Build/Lease variation of the BOT approach. For example, the projected extension of the Green Line from Lechmere to Tufts might be privately built, the operational components (tracks, signals, etc.) might be leased to the MBTA, and all support and ancillary components (stations, parking, etc.) might be retained and operated by the developer. The successful use of such an approach will depend in large part on the extent to which such an approach can be reconciled with the current requirements of Federal funding for mass transit.

V. Tax Increment Financing.

Tax increment financing is one of several financing mechanisms which was studied by the MBTA for possible use in conjunction with its construction of the Transitway to the South Boston Piers Area. The Transit Subcommittee received a presentation on this project and the various financing vehicles which had been considered by the MBTA. As the MBTA had largely concluded, most of these alternative financing mechanisms were not suited to current economic conditions in the region. For example, a betterment assessment financing mechanism would further disadvantage the economics of any real estate development project proposed in the area. The Finance Group did feel, however, that further consideration should be given to the use of tax increment financing for the unfunded portion of the Transitway and for other MBTA projects.

Tax increment financing is a mechanism used to fund infrastructure improvements in many states. It authorizes a governmental entity to pledge the increased tax revenue that results from the increase in valuation of property which is redeveloped by a designated project to the repayment of bonds issued to finance costs related to that project or the infrastructure which serves it. Only the increase in taxes resulting from such increase in value is pledged to repay money borrowed by means of this mechanism. Thus, no new taxes are imposed, and no new burdens are imposed upon the relevant property.

The Finance Group recognizes that the MBTA encountered local opposition to the MBTA's proposal to use such a financing tool with regard to the Transitway, with the opponents arguing that MBTA member communities are already subject to MBTA assessments and thus, should not be deprived of oral property tax revenue. The Finance Group believes, however, that as long as substantial

portions of MBTA costs are funded by the state and are not covered by member assessments, mechanisms such as tax increment financing, which serve to use some of the value actually created by the construction of new transit facilities to pay for those facilities, deserve serious consideration.

VI. Privatization of an Entire Transportation System.

One member of the Finance Group, who had the benefit of experience with Japanese affairs, obtained and provided to the Finance Group significant information regarding the massive privatization effort undertaken by the Japanese National Railways. The Japanese National Railway was a government entity responsible for much of the rail transportation in Japan, with 1985 operating revenues of approximately $27 billion. It operated at a serious deficit. In 1985, it lost approximately $50 million a day. This operating shortfall was repeatedly covered by borrowing, and the accumulated deficit at the end of fiscal 1985 was in excess of $180 billion. After lengthy study, the Japanese Government embarked upon a course of restructuring this debt, splitting the Japanese National Railways into numerous separate corporations providing both transportation and non-transportation services, and restructuring the management of the resulting companies. Although the information available to the Finance Group was only current through 1989, this privatization effort appeared to be financially successful, with the newly created companies showing respectable initial profits.

The Finance Group did not feel that the lessons the Japanese National Railways effort had immediate relevance for an urban transit system such as the MBTA, for two reasons. First, the differences in scale are so substantial that any generalization from the Japanese experience to the MBTA would be difficult. Second, from the limited information available to the Finance Group, it appeared that the newly privatized railway companies had fare box revenue which approached or exceeded operating costs. For the MBTA to be in a comparable position, its cost of providing service would have to be reduced significantly or its fares increased dramatically. The Finance Group felt that these alternatives were probably not realistic.

Perhaps the most useful lesson of the Japanese experience is that the restructuring of the Japanese National Railways was effected by national legislation, which made extensive provision for unemployment compensation, job retraining, and protection of related insurance and pension benefits. In light of the federal involvement in the provision of transit services both through subsidies and through related labor regulation, the Finance Group believes that wholesale privatizing of an existing transit system such as the MBTA could probably be undertaken only in conjunction with a federal program to restructure the provision of urban mass transit in the United States. Given various efforts abroad to privatize rail transportation (e.g., the efforts in Britain, Finland, Argentine and Portugal), the Finance Group concluded

that the Commonwealth should take the initiative to work with the Federal Government to see if viable strategies can be devised for the privatization of urban mass transit and commuter rail systems.

VII. Small-Scale Privatization Opportunities.

The Finance Group noted that there may exist a number of opportunities to privatize small segments of MBTA operation or to package and sell to the private sector small components or small opportunities of the MBTA's operation. For example, the MBTA could solicit proposals from private companies which would install, clean and maintain new or existing bus shelters in return solely for the right to sell advertising space in such shelters. Such an approach has apparently been successful to some degree in other cities both in relieving the transit system of a burdensome cost, and in producing more, cleaner, better maintained bus shelters.

VIII. Real Estate Redevelopment and Value Recapture..

Adequate financing for the MBTA is difficult because much of the value of the transit system cannot be reflected in the fare charged to users. A large component of this "lost" value is the increased value which the transit system brings to real estate located in proximity to it. As can be seen from the intensive development in the vicinity of the Alewife Red Line terminal, the proposed development along the Southwest Corridor, and the projected development in the South Boston Piers Area, construction of new transit facilities dramatically increases the development potential of adjoining land. As a rule, the benefit of this increased value currently flows to whatever party, public or private, happens to own the adjoining real estate.

Integrating transit construction with the real estate development activity which predictably follows could provide a significant capital source for transit development. For example, the MBTA might, in the fashion of a traditional redevelopment authority, be given the authority to take by eminent domain sufficient land not only for its immediate transit purposes, but also, sufficient adjoining land, the development of which would generate sufficient additional value to finance all, or substantial part, of the transit construction. The MBTA could then, under a Land Disposition Agreement ("LDA") turn both the developable and the transit corridor land over to a private developer, who would have the responsibility for building the transit segment, and the opportunity to develop the adjoining development parcels. The complex developments which have been built under the existing redevelopment statutes could serve as a general model for the type of authorization, the types of agreements, and the types of public/private partnerships which are workable in such an arrangement.

The Finance Group further noted that the MBTA needs to compile and computerize an inventory of its real estate holdings, in order to facilitate the more efficient use of its current real estate holdings. Such an inventory would allow the MBTA to identify unneeded holdings, and to offer them for sale to interested private parties.

APPENDIX A

Procedures Employed by the Finance Group

Over the past seven months, members of the Finance Group met with numerous representatives of the MBTA. In many cases, these meetings consisted of presentations by the MBTA to the members of the Finance Group and other members of the Transit Sub-Committee. These presentations range from an overview of the operational structure of the MBTA to detailed responses by the MBTA to specific requests from the members of the Group for information regarding particular aspects of MBTA operations or its financing.

In addition, members of the Finance Group met with representatives of the financial community, including Mr. John Gillespie of Morgan Stanley, and Mr. Thomas Green of The First Boston Corporation, and drew on the experience of such individuals with regard to the financing of the MBTA and other transit systems throughout the country.

Members of the Finance Group also met with Mr. Robert Kaiser, a consultant with COMSIS/UMTA, to discuss the private delivery of public bus service, and with Mr. Toshiki Saito, Economic Consul, Consulate General's Office for Japan. In addition, members of the Finance Group reviewed numerous studies and reports currently in the public domain regarding the financing and operations of the MBTA and other transit systems, as well as a range of literature regarding privatization of public services and entities.

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Date: [illegible]

: Mr. Harris [illegible] Jeard
Foley, Hoag and Eliot

Re: Transit Subcommittee Report

From: Richard F. Smith, Jr.

[illegible] the final [illegible] of the Finance Subcommittee report [illegible] and in response to Mr. Everett W. Lechnott's [illegible] recommendations, I think our last meeting that we elaborate upon the previous individual suggestions; please note the [illegible]. My thoughts here probably would not make it [illegible] the draft submitted to you by Peter, but based upon our conversations, I wanted you to know my thinking behind those items as chairman of the Finance Subcommittee.

What we should be concerned about is whether or not there exists a way to change the structure of the T (or, as mentioned, old T lowell or other such project), by making it a public company, maintaining responsibility to the public while at the same time enabling it to operate at a lower cost, and enhancing the future of rail and bus transportation in Massachusetts; and, hopefully the future of the state's economy. As Peter Herbert has pointed out, this would only be possible with great cooperation from the Federal Government. However, let's hypothesize.

What type of financial structure would you use to privatize the T?

There are currently several examples of "Private Companies" which benefit from a close relationship with the Federal government and which almost paradoxically enjoy the benefits of private sector including salary structure, benefits, monopolies and access to the public markets, yet they are in fact Federally subsidized. For example, Freddie Mac--with 10.9 billion in debt, and Fannie Mae--with 88 billion in debt, these agencies enjoy a monopoly on the securitization of mortgages in the U. S. They have no real competition, yet their stock is now publicly traded as quasi-public companies and they enjoy benefits allowed only to the federal government. (i.e., exemption of SEC review of security offerings and extremely low financing costs--because of the implicit guarantee by the Federal Government of their credit). In a pure sense the equity raised from these public offerings has taken money from the private sector, eliminated possible competition.

The Federal Government has taken equity positions in troubled banks in the past. And, will probabl continue to do so in the future, as the rescue of our financial system proceeds.

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The Federal Government in conjunction with the RTC controls a warehouse of $150 billion in assets nationwide. The FDIC now exercises control of more than 20% of the real estate in New England. Hence, the Federal Government is now a major factor in the national realty market and, in New England at least, based upon its near term policy, decisions will effect the value of residential and commercial real estate for years to come.

In reality, given the extent of the Federal Government's involvement in the areas of employment, environment, housing, etc., the line between the public and private sector is illusionous at best.

If the Federal Government can have the benefit of a public corporation, why can't the state, for example, why can't the state build a private transportation corporation, perhaps, using state pension funds in concert with other financing mechanisms.

As with Amtrak, why can't the Federal Governments contribution to the state's transit system be in the form of preferred stock, convertible preferred stock, or some other form of security?

Why couldn't the state explore the possibility of issuing stock of the new company in different classes. (e.g. a class A class, with different degrees of voting control.) Why can't the current state contributions/subsidies form the T member districts be reclassified as an equity investment rather than a straight subsidy. Perhaps funding in the form of equity, and the share holders concern and responsibility which accompanies such an investment, instead of assessment, would act as an incentive to increase the local funding to the T. Perhaps a rights offering to communities outside the T district would generate additional revenue.(i.e. communities hoped to be served by high speed rail with links to the T, and other future transportation projects)

Our brief review of the literature suggests expertise in what is being called "privatization" being developed by other nations (Japan, Great Britain, Norway, Portugal, Malaysia, Argentina, Peru, Canada) in terms of financing, debt and equity capital funding, and the sale of assets.

At first glance it does not seem that lessons learned from these privatization efforts of national systems can apply to the T, however a little thought warrants additional consideration.

Briefly, on average, based on 1989 figures, the federal government contributes 4% of the operating funds ($15.2 million), and 60% of the capital funds ($57.6 million) to each of the largest 30 transit systems in the U.S. This compares to the contribution of state and local governments of 41% of the operating funds ($142.0 million),

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and 27% of the capital funds ($334.6 million). In short, the federal government now contributes an average $72.8 million or 29% of the operating and capital costs to each of the largest 20 systems, or total almost $2.2 billion on an annual basis.

Given the above figures there is no wonder UMTA is actively encouraging private contracting and bidding practices. Just in terms in controlling this growing runaway expense, the Federal Government needs no additional incentive to pursue new methods of capitalizing local transit systems. Of necessity they should be amenable to the type of proposal we are recommending in the Finance Subcommittee report.

Just as we are looking at these privatization methods other states will be studying these matters in the near future. If Massachusetts is not the leader in the recapitalization and capital formation techniques, if Massachusetts does not prod the feds into acting, some other state or regional transit authority ultimately gain the financial advantage or rewards.

A related question is, why should one company--Amtrak--be allowed a monopoly in the growing market for expanding rail service? If one considers the operating revenues of Amtrak and the fact that it operates nationwide it generates revenues of only $1.1 billion and has a federal subsidy of $560 million. The 20 largest transit systems combined had revenues of approximately $4.2 billion for 1989. That is at least 4 X's Amtrak. There is room for private market growth and competition in this area. Some of the technical expertise required by Amtrak is also required by local transit systems. What is needed is restructuring, greater efficiencies, competitiveness, incentive, and help from the federal government in establishing a level playing field.

If methods aren't implemented to modernize the financing techniques and ownership structures of U.S. transit systems a more ominous scenario must be considered.

For example the decline of U. S. expertise in transit matters is reflected in the current rebuilding of the infrastructure of Taiwan, (N.Y. Times ,10/27/91). A few U.S. companies will receive contracts for $100 million to $200 million, but American companies will be locked out of the main contract for high speed railway system, partly because the U.S. does not have a system. Instead Japan, France and Germany will compete.

Ultimately, if this trend continues, these countries will be competing for similar turnkey contracts in other nations, and most likely competing within the United States as well. Further, with the expertise these countries learn from creating market value through the capital markets. They will an advantage be offering management services,.system development, financing and equipment.

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Perhaps, along the outline of the Japan National Rail or the British Rail systems. They will have access to the capital markets, technical expertise, and the U.S. will be left behind unable to compete in this dynamic growth area.

As a nation we have been caught short in the competitive areas of banking, autos and consumer products. It would be a tragedy if we lost in the field of rail transportation as well.

For all the above reasons the EOTC should, as suggested in the summary report to the finance committee strongly solicit the cooperation of the federal government in exploring new forms of capital formation, ownership of rail systems and the creation of private market value of the assets controlled by the T.

Two items which pertain to the above: 1) Mr. William Kennicke (see enclosed letter copy), a committee member who has provided information on the privatization of rail in Argentina, has suggested an opportunity which may exist for the wholesaling of electric power by the T). A previous memo (dtd. 10/18/91), which I drafted to the finance subcommittee listed several areas where the T might have or be able to develop expertise which should be capitalized upon. 2) An example of possible competition for Amtrak, was mentioned in today's Boston Globe(11.7.91). Guilford Transportation Industries, Inc. of Portland, Maine, has introduced a proposal suggesting it was prepared to offer rail service between Portland and Boston at a cost 20% less than Amtrak.

Besides, already Texas, West Virginia, Florida, California, Utah and others are struggling in their attempts to develop high speed rail. The ideal section for such a train is between N.Y. and Boston. Before the funds are spent to upgrade the rail between N.Y. and Boston. Perhaps a more definitive study should be done to estimate the possibility of constructing a maglev or similar high speed system between these cities--a real showcase to the country, along an artery where its truly needed.

These markets are just beginning to open. If Massachusetts does not act to become a leader and protect the assets and the future of its citizens. The next generation will not only criticize us for our lack of foresight, but will pay dearly for our lack of courage.

TEMPLE, BARKER & SLOANE, INC.
MANAGEMENT AND ECONOMIC COUNSEL

November 5, 1991

Mr. Peter D. Corbett, Esq.
Goulston & Storrs
400 Atlantic Avenue
Boston, MA 02110-3333

Dear Peter:

I have reviewed the preliminary draft report of the Finance Group to the Transit Subcommittee of the Privatization Task Force and feel it does an excellent job capturing the essence of the many diverse topics that were discussed at the finance group.

There is one additional comment that I wished to add for consideration involving the privatization or selling off of components of the MBTA infrastructure. The example that comes to mind is the power distribution systems for the electrified lines. The MBTA has an internal requirement for power distribution that will need upgrading the repair in the future years. At the same time the deregulation of the utility industry may offer opportunities for the wholesaling of electric power outside of the traditional franchise area into other markets. Could a private party be sold the rights to use the MBTA right of way and tunnels to provide a "third party" distribution grid? For example, this grid could provide linkages between aggressive low cost power producers and and major down users such as a major office building. Value would be created for the MBTA through the sale or lease of these access rights and they could piggyback their own electrical distribution needs on the third party network. The same could work for a downtown third party fiber optics network wired in to the major office and retail complexes.

Finally, I would like to apologize for not being able to attend all of the meetings. Our company is in the middle of privatizing the commuter railway in Argentina and I have spent a good deal of time traveling the last four months. Thank you for allowing me to participate in the finance committee activities.

Sincerely,

William J. Rennicke

33 Hayden Avenue · Lexington, Massachusetts 02173 617/861-7580 Telex 951929

COMMONWEALTH OF MASSACHUSETTS

Privatization Task Force
Transit Committee

Report of the Real Estate Subcommittee

The report which follows contains the general comments and recommendations of the members of the Real Estate Subcommittee. This Subcommittee was chaired by Malcolm Davis. Charles Beard, Thomas Harvey and Michael Sinclair worked on the Subcommittee. The Subcommittee members would like to acknowledge at the outset the work of the staff members of the MBTA who provided information to the Subcommittee. The staff members were thorough in their presentations and quite helpful. We appreciate their willingness to share their information and their views with us on very complex subjects.

Background: The concept of privatization of modes of transportation, for us, is an approach to solving problems of providing public transportation. The Executive Office of Transportation and Construction ("EOTC") is engaged in promoting the development of various transportation services, some public and some private. We believe that EOTC should promote the use of transportation services other than cars. To successfully promote these transportation services, EOTC must achieve several goals.[1]

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[1] We think EOTC must encourage transportation by modes other than cars for the following reasons. Recent studies by the U.S. Department of Transportation show that, on a national basis, people are relying on their cars more than ever before. 89% of person trips are taken in cars. The number of occupants per car has dropped from 1.4 to 1. The number of miles traveled by car is about 2.1 trillion miles per year and the number is increasing. The number of person trips taken by airplane is about 10%. In contrast, the number of person trips taken by transit -- including rail, bus, and boat -- is less than 1%.

The services should be reliable, which means that users can depend on the services in accordance with a preset schedule without interruption or inconvenience. The services should be efficient, and competitive with the amount of time it takes to travel the same distance using alternative transportation modes. The services should be fairly priced. This concept includes a number of factors such as the cost of alternative transportation modes, the time it takes to use alternative transportation modes, the benefit to the business which are situated close to the transportation stops and the benefit to the public at large.

In this context, privatization is the search for the most sensible way to achieve these goals for each mode of transportation. It seeks to use private resources, whether equity funds invested in a public/private partnership or private contractors providing a particular service, whenever those resources will help achieve the goals. More importantly, it seeks to change the incentive structure for providers of public transportation services so that managers and employees can work more effectively to achieve the goals.[2]

Three pending pieces legislation, will encourage alternatives to cars by permitting between 33% and 60% of highway funds to be used for highway alternatives. The Administrator of the Federal Highway Administration believes that some version of the bills will pass this year and that funding for highway alternatives will become available.

[2] The benefit for public employees may be that greater success in achieving these goals may lead to higher compensation and job satisfaction for those involved.

With this background in mind, we have several recommendations.

Benefit Assessment Districts: In the planning for new projects, such as the Old Colony line restoration, we think that the creation of a benefit assessment district should be seriously considered as a means of having local businesses which will benefit directly from the construction of the line contribute to the costs of construction. This concept has been used with some success in Los Angeles County, where the Southern California Rapid Transit District (SCRTD) was authorized to establish benefit assessment districts around one or more Metro Rail stations. There, benefit assessments were designed to raise 10% of the needed construction funds. The assessment district included an area within 1/2 mile from transit stops in the Central Business District, and 1/3 mile from transit stops in other commercial areas. Space used for offices, commercial, retail, hotels, motels, and vacant parcels were assessed. Residential properties was excluded from assessments. The assessment will terminate once the bonds are retired. A similar approach has been considered in Toronto, Canada, where an extension of a subway system in being planned.

Dedicated Revenue Stream: Twenty two states have dedicated revenue streams for public transportation, but Massachusetts is not among them. We think that approach should be seriously considered for the MBTA. The goal is to get a dedicated revenue

stream to reduce the net cost of service[3] of the MBTA, thereby reducing the burden placed on the participating cities and towns. At present the Commonwealth pays 80% of the net cost of service, while the towns pay 20%. As the annual net cost of service grows in future years, the burden on both the Commonwealth and the cities and towns will grow as well.

Capital Projects Privately Funded: Several strategies should be explored to attract private funds to finance capital projects at a cheaper cost. First, strategies should be explored to attract equity funds into projects. Public/private partnerships should be explored in this respect. One such model was proposed in Toronto. A group of private companies were to create a joint venture which would contribute 10% of the cost of an extension on the Toronto subway system. The joint venture would then pre-sell concession space in the subway stations. They would then raise the debt needed to complete construction of the project. The subway authority would lease the completed system from the partnership. Lease fees, along with benefit assessments, would amortize the debt and provide the partnership with a reasonable return. While the specific proposal made in Toronto was considered to be too generous to the private partnership, the concept was worthy of further exploration. We think this concept, and others like it, could be used successfully in Massachusetts.

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[3] "Net cost of service" is defined as the MBTA income, less operating expense, less debt service payments on bonds for the capital program, plus financial assistance from the Commonwealth and the Federal government.

Second, particularly while the Commonwealth's financial condition is so precarious, we think that consideration should be given to having the MBTA issue any additional bonds needed to raise funds for construction projects at the MBTA. This strategy should be followed immediately if, as we believe, the interest rate on bonds issued by the MBTA will be lower than the interest rate on bonds issued by the Commonwealth.

Parking Facilities: We note with interest that the MBTA has been successful in turning its parking facilities into a profit center. It may be possible for the MBTA to further develop these facilities and to increase significantly the profits derived from them. We think the important principle here is that the MBTA should limit its activities to matters related to its transportation mission. We think the MBTA should be encouraged to develop additional parking facilities only to the extent that the facilities are situated to enhance the use of transit facilities. Part of the reason that the parking facilities have been profitable is that they include concessions. We think that the same principle should be applied here. The MBTA should be encouraged to develop space for concessions only to the extent that the concessions will attract riders.

Power Generation and/or Purchase: We have examined with some interest the proposal of Boston Edison ("BECO") to purchase certain electric power generating and distribution facilities of the MBTA. Such a purchase would be consistent with our view that the MBTA should be in the transportation business, not in

ancillary businesses. After examination, however, we are persuaded that BECO has not made a proposal which fairly meets the legitimate concerns of the MBTA. For example, we are convinced that the MBTA should control enough standby power generation to provide power in the event of a power outage. Having this power generating capacity also qualifies the MBTA for access to cheaper power through the New England Power Pool. It can purchase power from a variety of suppliers at rates lower than it could purchase power from BECO.

The BECO offer for certain facilities and vacant land is far from the price valuation which the MBTA holds. If the MBTA sells assets purchased with UMTA funds, 80% of the proceeds received from the sale have to be returned to the federal government. Similarly, the elimination of jobs raise important collective bargaining issues and UMTA issues which would have to be resolved.

MBTA Land: Our meetings with the MBTA Property Management Department and the MBTA Properties Development Department were informative and comprehensive. The MBTA does not pay real estate taxes on its holdings, including the land it acquired from the Boston & Maine Railroad. While there may not be pressure to sell surplus land, the MBTA seeks income from land leases. It cooperates with towns and individual property owners to sell off "slices" to regularize parcels without compromising its right-of-way corridors or support sites. We think that approach is sound and should not be changed.

MEMORANDUM

To: Transit Subcommittee, Real Estate

From: Malcolm M Davis

Date: 22 October 1991

RE: Benefit Assessment Districts

I have reviewed the material provided to me by Michael Brennan, MBTA, on Benefit Assessment Districts which was provided to him by Michael Smith, Assistant Treasurer of the Los Angeles County Transportation Commission.

Introduction: State (California) Public Utilities Code 33000, et seq., authorizes the Southern California Rapid Transit District (SCRTD) Board to establish benefit assessment districts around one or more Metro Rail stations and to assess property located within specified distances from the stations. The SCRTD Benefit Assessment Program was established following a series of citizen task force and community meetings, two public hearings and formal action by the Los Angeles City Council and the SCRTD Board of Directors. In July 1985, the SCRTD Board adopted a resolution creating two special benefit assessment districts - one for the Central Business District, and one for the Wilshire/Alvardo area. Revenues from these districts will be used to pay part of the construction costs for the first segment of the Metro Rail rapid-transit system. Construction costs for Segment-1 are to be met by federal, state, county, and city funds, plus private-sector revenues generated via assessments.

Benefit assessments have been used in California and throughout the United States to finance such public improvements as street lighting, sewer systems, parking structures and flood control facilities. Owners of property near the public improvements receive special benefits resulting from the public investment. Those receiving the most direct benefits are asked to share in the project's

cost through benefit assessments. For Metro Rail, property owners near subway stations will realize various monetary benefits. Thus, they are being asked to share in Metro Rail costs. Residential property is excluded from SCRTD assessments.

Need for Assessment Program: There is a genuine need for benefit assessments. Segment-1 construction will cost some $1.25 billion when completed. Of this, the federal government will pay $695.9 million (56%), the State of California will pay $213.1 million (17%), the Los Angeles County half cent sales tax (Proposition A) will contribute $176.6 million (14%), and the City of Los Angeles will provide $34 million (3%). An additional $130.3 million (10%) is needed to construct Segment-1, and SCRTD benefit assessments are designed to raise these funds.

District Boundaries: For the most part, direct benefits from a rapid transit system occur because people walk some distance to and from the stations, creating additional pedestrian activity and improved access for properties near the stations. This results in increased levels of commercial activity and enhanced opportunities for commercial growth and real estate development. As a result, walking distances from station centers of 1/2 mile for the CBD and 1/3 mile for the Wilshire/Alvarado area were primary determinants of benefit assessment district boundaries. Additionally, a set of rules regarding inclusion of city blocks, consideration of barriers to walking and adjustment of boundaries for irregular shapes were used to define the boundaries.

Assessment Rates: The 1986 assessment rate is thirty cents ($0.30) for each assessable square foot of property. The annual rate may be increased or decreased to generate necessary revenues to finance a portion of the construction, but the rate will never exceed forty-two cents ($0.42) per square foot. The SCRTD Board will review the rate at least every two years and may adjust the rate to reflect changes in assessable square feet within a district. If additional

assessable property is constructed, rates could be lowered accordingly, depending on cash flow needs. Changes in land use and development in a district will be updated on the assessment roll annually.

Assessment Collection and Use: Benefit assessments will be collected by the Los Angeles County Tax Collector by way of Joint Consolidated Tax Bills. Revenues will be used as security to back bonds, and assessments will terminate once the bonds are retired - the year 2008 or earlier. Total assessment for the CBD and Wilshire/Alvarado districts will not exceed the amount needed for or to finance $130.3 million in capital construction costs, plus any associated interest, bond issuance and direct program administrative costs.

Exempt Properties: The term 'property' in the SCRTD Benefit Assessment Program includes both parcels (land) and improvements (buildings). Three types of properties are exempt from assessment: Residential property (except for hotels and motels); Property both owned and used by a public entity; and Property both owned and used by a qualified non-profit organization.

Properties Subject to Assessment: The following properties are assessed: Improvements used as offices, commercial, retail, hotels and motels; and All parcels. Annual assessments for these properties are calculated using either the square footage of the parcels or the square footage of the assessable improvements located on the parcel.

MEMORANDUM

TO: Malcolm Davis

FROM: Charles J. Beard

DATE: October 7, 1991

RE: Summary of Toronto Materials

I have now reviewed all of the materials you sent me respecting the use of privatization strategies in the proposed expansion of the Toronto subway system. This memorandum is a summary of the ideas contained in those materials.

In March, 1990, the Task Force on Financing Infrastructure Capital Expenditures[1] (the "Task Force") reviewed a proposal advanced by Solution Through Partnership[2] for the financing on an extension of the Toronto subway system (construction of the Sheppard Subway Line) through a public-private partnership. The Task Force started with three basic principles to describe the circumstances under which a public private partnership seemed workable. They included:

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[1] The Task Force on Financing Infrastructure Capital Expenditures is composed of the Chief Administrative Officer for Metropolitan Toronto, along with the heads of the departments of Works, Treasury, Transportation, Planning, Parks and Property, Legal and the Toronto Transit Commission. The Executive Director of Economic Development of the Chairman's Office and the Director of Corporate Planning of the Management Services Department are also members.

[2] Solutions Through Partnership is composed of Arendsnest Corporation, Bramalea Limited, Counsel Trust, Olympia and York Developments Limited and Westnor Limited.

1. The existence of a problem that neither the public sector nor the private sector could or for some reason would solve independently;
2. A proposed activity that if undertaken would yield mutual benefits to all members of the partnership; and
3. An understanding that all parties are in possession of something that could be brought to the partnership that the other parties wanted or needed.

The Task Force then evaluated the plan for the expansion of the subway system against these principles.[3] It estimated that the total construction costs for the proposed expansion, including hard costs (construction, rolling stock and property acquisition) and soft costs (engineering, administration and construction management) would be approximately $1.143 billion, and it concluded that the public sector simply did not have the capacity to raise the needed capital. The Task Force then described and evaluated a public-private partnership proposal advanced by Solutions Through Partnership. This proposal estimates that the total project cost would be $1.071 billion because of reduced needs for interim financing. The proposal to finance that sum was that a group of private investors would create a partnership in which they would invest $107 million (10% of the project cost). Concessionaires, advertisers and sponsors

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[3] To put this analysis in perspective, the Task Force described five different models for financing rapid transit which are in use today. There was no meaningful discussion of the models. They were summarized in a chart which is reproduced at the end of this memorandum.

would purchase their respective rights in the subway system extension for $84 million (7.8% of the project cost), and the balance of the project ($884 million) would be financed with long term (40 years, 12%) bonds. The project would then be leased to the Toronto Transit Commission, which would pay the lease fee. The partnership would also receive funds derived from three additional sources: 1) an annual levy on existing commercial developments in the transportation corridor in recognition of increased value to the property; 2) a one time charge on unused residential and commercial density rights up to the existing Official Plan; and 3) a one time charge on increased residential and commercial density rights beyond those currently permitted under the Official Plan as building permits are issued. These funds would all be paid over through agreements with the towns which are affected by the new transportation unit.

The model proposed by Solutions Through Partnership projected:

1) a 23% reduction in the long term debt requirements for the project, when measured against a conventional financing which would have 100% debt; and
2) a 35% return on equity to the partnership (based on the contribution of 10% equity and 8% sponsorship contribution) if 100% of the revenues listed above were dedicated to the partnership, and a 30% return on equity if 75% of the revenues were dedicated to the partnership.

The Task Force found that the return on equity was too generous. It thought that the equity contribution to the project should be greater and the percentage of revenues dedicated to the partnership should be lower. The Task Force found returns in the 13%-16% range much more acceptable.

In sum, the Task Force felt that the proposal as presented was not a "good financial Deal for Metropolitan Toronto." The Task Force felt that public private participation for this particular project was a good idea, and it recommended that the Metropolitan Toronto Council solicit proposals from the private sector that would propose concepts of public-private solutions to finance the construction of the Sheppard Subway Line. The Task Force recommended that Solutions Through Partnership be invited to submit a new proposal, one with increased equity investment and a reduced dedication of revenues to the partnership.

These findings were summarized in a memorandum from the Task Force to the Management Committee of Metropolitan Ontario, dated March 27, 1990. The memorandum restated the basic evaluation criteria in a more elaborate fashion, as follows:

1. That Metropolitan Toronto acknowledge the potential role for the private sector in the provision of major public infrastructure.

2. (a) That the opportunity to participate in any public-private venture contemplated by Metropolitan Toronto be open to all interested parties. Interest is to be demonstrated by way of a response to a public call for concept proposals.

   (b) In the case that a proposal has been submitted on speculation and the suggested project is determined to have merit, that a public proposal call be undertaken unless it can reasonably be determined that no other party would be interested in participating.

3. (a) That in general the public sector's responsibility for operating public facilities be assumed by the private sector only in the case that the existing standard or a higher standard of service can be guaranteed.

   (b) That the operation of the subway system remain the responsibility of the public sector with private sector involvement in operations contemplated only in the case of augmented services.

4. That no proposal be considered that is predicated upon the public sector's disregard or abandonment of due process in determining community goals.

5. (a) That there be complete disclosure of all information that relates to the private sector participants and their interests in the venture.

(b) That the benefits that would accrue either directly or indirectly to the participating private sector members be evaluated on an individual and collective basis.

6. (a) That the return to the private sector participants be in direct relation to the degree of participation and risk that the public sector expects the private sector to take and that the return is fair and publicly defensible.

(b) That the public sector's indebtedness to the private sector not be tied to any type of commitment that provides the private sector exclusive access, either directly or indirectly, to a significant municipal own-source revenue.

(c) That a public sector benefit/cost evaluation be conducted respecting any project involving a partnership with the private sector.

In February, 1991, the Chief Administrative Officer (the "CAO") of the Municipality of Metropolitan Toronto ("Metropolitan Toronto") issued his own recommendations to the Management Committee of Metropolitan Toronto respecting the capital needs of Metropolitan Toronto. He analyzed the capital needs of Toronto for the ten years (1991-2000) and concluded that the current fiscal policies were inadequate to provide the $6 billion needed during that period, and that simple adjustments in the financing

policies would not improve the situation significantly. He felt that new taxes would be needed to provide the revenues for the proposed capital expenditures.

The CAO first examined development charges as a new source of revenue, and he recommended against their further use for two reasons. The first is that the relevant Canadian statute (Bill 20), which was recently enacted, is designed to let local towns levy the charges, rather than regional governments. Even though the CAO had Bill 20 amended to some extent before passage, Metropolitan Toronto still has limited authority to levy such charges. The problem is made worse because the various town boards and school boards with authority to levy such taxes are not required to coordinate their levies; there is no requirement, for example, to ensure that the combined charges in a given area do not exceed the point beyond which development within the area is no longer affordable or feasible.

The second reason is more conceptual. Because the development charge is a one time charge, the resulting revenue stream varies considerably from year to year. It is not the stable kind of revenue stream which a government could rely on comfortably to amortize debt instruments.

Instead, the CAO recommended serious consideration of five other financing instruments, either individually or in some combination. They are as follows:

1. Special rates and special charges, which permit local municipalities to levy charges against existing properties to finance additional capital facilities or to improve existing facilities. The assumption is that local municipalities recoup a portion of the capital investment because the present population benefits from the investment, not future populations.
2. Density bonusing, a concept already embodied in Section 36 of the Planning Act. Essentially, a local municipality may authorize increases in the height and density of a development which is otherwise permitted in exchange for the provision of new facilities, services or other benefits. The proposal is to extend the concept to include payments to Metropolitan Toronto. Since Metropolitan Toronto provides some of the infrastructure which makes the increase in density of a development possible, it should share in the benefits which accrue as a result.
3. Land value capture strategies are to be considered for further study. The CAO thinks that taxation based on increases in property value captures only a small portion of the economic benefit enjoyed by the private sector.
4. Beneficiary charges beyond the boundaries of Metropolitan Toronto. The proposal here is that municipalities beyond those through which the transit

system operates may benefit directly from its proximity, and they should be asked to contribute to the amortization of capital costs.

5. Connecting fees, including the sale or lease of rights to a property owner or developer to connect their developments to an existing or future subway station deserves further study as well. These fees might come in the form of having developers pay for connecting structures (e.g., escalators or stairs) as well as making contributions to the capital costs.

The CAO concluded by recommending that a revenue package with three components be submitted to the legislature: a) benefitting area special levies; b) unused density charges; and c) premium density exchanges.

This summary is quite brief, but I hope it is helpful nevertheless. The other two documents you provided me, the glossy brochure and the two page document entitled "Toronto Benefits" did not provide any meaningful new ideas. If you need additional information, please let me know.

TABLE 1

RAPID TRANSIT FINANCING MODELS INCLUDING PUBLIC-PRIVATE PARTNERSHIP MODELS

	NAME OF FUNDING METHOD				
Element of Rapid Transit System Implementation	1. Conventional Model	2 Private Sector Equity	3 Private Sector Equity plus Land Value Capture[1]	4. Conventional Model plus Land Value Capture[1]	5 Build, Operate Transfer[2]
Description of Funding Method	Conventional sharing of costs between local and Provincial/State/Federal Governments	Private sector contribution to cost of construction as an incentive for construction of rapid transit line in return for increased density and/or relief from property taxes	Private sector contribution to capital cost as an incentive for construction of rapid transit line in return for right to collect land value capture revenues	Conventional sharing of capital costs between local and Provincial/State/Federal Government. Land value capture revenues retained by government	Private sector builds and operates system for a specified period of time and then transfers ownership to the public sector for a nominal amount
Examples in Other Jurisdictions	Numerous	Canary Wharf, London Docklands Light Railway	Solutions Through Partnership Proposal (Sheppard Subway)	Los Angeles, San Francisco, Miami, Denver, San Diego	Ankara, Turkey
Who Builds	Transit Operator	Transit operator and/or public private partnership	Private partnership (Sheppard Subway Partnership) or Public Private Partnership	Transit Operator	Private Sector
Who Operates	Transit Operator	Transit operator and/or public-private partnership	Transit Operator (T T C)	Transit Operator	Private Sector
Who Pays for Construction	Local and Provincial/State/Federal Governments	Private sector contribution with remainder by government	Private sector contribution with remainder by government	Local and Provincial/State/Federal Governments	Private Sector
Who Retains Fare Revenue	Transit Operator	Transit Operator	Transit Operator (T T C)	Transit Operator	Private Sector
Who Provides Operating Subsidy	Local and Provincial/State/Federal Governments	Local and Provincial/State/Federal Governments	Local and Provincial/State/Federal Governments	Local and Provincial/State/Federal Governments	Private Sector
Land Value Capture	No	No	Yes	Yes	No
Who Retains Land Value Capture Revenue	NA	NA	Private Sector and/or Government	Government	No

(1) Land value capture refers to the practice of recovering part or all of the value of public investment in infrastructure from the private sector (i.e. through development charges, special property tax zones, levies, density charges, etc.)

(2) An alternative to the build, operate, transfer model is where the private sector builds and operates rapid transit in perpetuity (i.e. no transfer to the public sector at a future date)

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MEMORANDUM

DATE: October 27, 1991/REVISED October 30, 1991

TO: Malcolm Davis, Charles Beard

FROM: Tom Harvey

SUBJECT: Review of MBTA Staff Response to BECO Proposal to Purchase Certain Power-Generating and -Distribution Assets

As a part of the activity of our Real Estate Subcommittee, I have reviewed the staff response to the BECO proposal to purchase certain electric power generating and distribution facilities of the MBTA in the name of privatization.

The BECO proposal offers $10 to $12 million for the turbine generator and $4 to $6 million for the vacant land next to New Boston. The proposed price for the 115kV/13.8kV substation and the 13.8kV distribution network is under study by BECO. No mention was made in the proposal of the 600V DC distribution system.

MBTA electric power system management with the assistance of experts from R. W. Beck Associates developed the following response to the BECO offer. I was able to review in detail the information earlier presented to us when I visited with Tom Furmaniak after our Real Estate Task Force meeting last Thursday.

1. The present worth to the MBTA of the turbine generator is about $40 million. This estimate is based in part on the current 14-year contract, extendable to 20 years according to R. W. Beck, which MBTA has with BECO to provide the generator for standby power at a fee from BECO of $2.2 million per year. It also assumes the purchase and installation of a second generator for an additional fee of $1.74 million per year under similar terms. A discount rate of 7% has been used, said to be consistent with that used by BECO in presentations to the Massachusetts DPU.

2. MBTA estimates the market value of the land next to New Boston at $14.5 million. MBTA recommends that any sale of land be competitive to enable MBTA to obtain its fair market value.

3. The present value of the 115kV/13.8kV substation is $74 million. This facility makes it technologically possible for MBTA to purchase power under a special contract rate from the New England power pool instead of being compelled to purchase it from BECO at the MT industrial rate.

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The presence of the turbine generator and this substation are the physical ingredients implementing the special Massachusetts legislation which permits MBTA to join the New England power pool and to obtain power from any and all other members of the pool under competitive bid. Thus they are not restricted to purchases only from BECO who MBTA staff feel is a high-cost producer relative to the other members of the pool.

4. The present value of the 13.8kV distribution system is $363.1 million.

5. The total cost of the proposed purchase would approximate $500 million. BECO has an annual investment capacity of about $200 million under the current DPU-approved rate structure. R. W. Beck estimates that the purchase would cost BECO rate-payers an additional $70 million per year. Also, BECO currently has surplus capacity.

6. The proposed sale would require UMTA approval, and the sale would have to be made by competitive bid. 80% of the proceeds from any asset purchased with UMTA funds would have to be returned to the federal government. The loss of this function by MBTA would result in the elimination of 42 jobs, (out of a total of 127 to 132 in the power group). The need under section 13c of the UMT Act to obtain Department of Labor and union approval could precipitate a crisis.

7. Removal of the generator would leave MBTA at the mercy of BECO for restoration of electric power. This loss of control by MBTA as well as loss of the assurance that service by the electrically-powered vehicles could operate with a minimum of disruption in any BECO or network power outage is of great concern to MBTA management.

If there are any questions about this material, please feel free to call me at 508-371-4336.

Commonwealth of Massachusetts

Privatization Task Force
Transit Subcommittee

Report of the Boat Transportation Subcommittee

Overview

The following are general comments that our Committee has developed based on presentations made before the full Privatization Task Force and to the Privatization Sub-Committee for boats.

The Committee is made up of Terry Fancher, Tom Harvey representing HMM Associates and John Medeiros representing American Eagle Motorcoach. Other members include: Arthur Casey, and John Greene. Over the last month, we have had an opportunity to speak with people who have been in positions of influence that dealt directly with the boats. We have also talked at great length with boat owners, and we have had the opportunity to take an in-depth look at the MBTA marketing plan for commuter boats.

Transportation needs to be thought of in a Global nature. The state should get away from promoting boats, buses, vanpools, rapid transit or commuter rail in isolation from one another and should strive to create most cost-effective overall system for moving people. Equity among private sector providers as well as transit patrons is an issue. Private enterprise should get a chance to bid on service, especially when looking at new service or in areas where there is existing low-level service. Private enterprise also needs to know when new service is being contemplated so there is adequate time to bid on the opportunities. The goal of all service should be to provide a ride that is comfortable, reasonably priced and consistent at all times of the year.

Fairness

One of our major questions is that of fairness. We need a transportation policy that takes into account public interest and is also fair to service providers. The question that came up a number of times was that of making capital investments or operating investments into not only the boat service, but all other transportation modes as well. It is our suggestion that the state use an organization, such as Central Transportation Planning Staff, to develop a standardized format for expenditures, so that all services can be compared. The MBTA as a provider is viewed as a competitor by private operators. Central Transportation Planning Staff is viewed as having a more even handed view of operators and having a good grasp of the public interest. What transit improvements provide the most "bang

for the buck?" One criterion is level of fare box recovery. The apparent inequity when fare box recovery is about 31% on commuter rail, but approaches 50% on both boats and buses needs to be examined. The state could either raise the fare box recovery on the trains or lower it on the boats and buses, or justify on the basis of the greater public benefits received on the more heavily subsidized mode. A consistent policy is needed.

Existing Boat Service

In examining the existing boat service operations, we find that it is reliable and comfortable, but that it has limited access unless people live close by. We find this to limit its potential, and believe that the State should look at providing better inter-modal connections between the boats, buses, and the trains. We have found that people who take the boat service love the service, and once they get used to it, it is hard to get them off the boats.

It is also our belief that the existing commuter boat service is price sensitive, and if the prices go up too high, people will leave the service and either drive to and from Boston or take other forms of mass transit which are cheaper. One boat owner had done a survey which indicated that commuters were willing to take a longer ride, just as long as the price did not go up.

Future Operations

There are several aspects of future operations that we believe the State should look at. Service must be consistent, and the service should not be changed year in and year out based on the number of operators and runs. People need to be secure in knowing that the boats will run. We also believe that the State needs to spend more time in looking at the potential air quality improvements of taking all forms of transit, including the boats as an additional criterion for evaluating privatization options. High Occupancy Vehicle lanes should also be factored into this air quality study.

We do see potential for joint development issues and air rights at commuter boat terminals in the future.

State Transportation Plan

We need a transit plan for the State, and not just a boat plan. The Secretary of Transportation should be in the business of pushing all modes of transportation with inter-connections between each. To that end, we need to investigate the shared uses of boats, buses, and van pools with other agencies during weekdays and weekends.

Overlapping Agency Missions

We were shocked to find the number of local and state agencies that are directly involved between the time a person gets to a boat, gets on the boat, and gets off the boat at the other end. In some cases, the jurisdictions go between the Department of Environmental Management, to the State Department of Public Works, to the MBTA, to the Massachusetts Port Authority, to the Local Department of Public Works, and in some cases to a Local Developer Advisory Board.

Landside Facilities

It is our belief that landside connections need to be addressed. There is still no direct bus connection that goes to the Hingham Shipyard for the Hingham to Boston boat. There also seems to be a lack of connections on the Boston end to get people to various places within the City of Boston, and the Prudential Center has been mentioned as one of those areas that need to be considered for some sort of service. The accessibility for handicapped people needs to be looked at closely. The question has been raised by the boat owners about why they should have to pay for accessible boats when it is a State or Federal standard that has to be met. Their concern is that no monetary investment is there to help them meet those standards.

Private versus Public-owned boats

The current system was generally agreed upon with the stipulation that companies receiving subsidies should not be allowed to provide the same type of service as is currently being provided by boat owners with no subsidies at all. In other words, a commuter boat receiving a subsidy should not be able to directly compete with an islands cruise or harbor cruise, which is already being provided by a private operator with no subsidy. All boat operators should be allowed to bid on commuter boat runs, even though they may not currently be providing that type of service. There were some comments that the State should consider helping the boat owners through capital investments rather than operational subsidies, and that those capital investments would include landside facilities in the form of canopies to protect people from foul weather, not only on gangways, but in rest areas, and that covered parking be considered in some locations. The question of contracts was also raised, and it is the belief of the Task Force that the contracts should be standardized so that they can be compared with contracts of other forms of mass transit. In that respect, administrative costs, fuel costs, and electricity charges should be reflected not only in the cost of running boat and bus service, but also for commuter rail service and MBTA Mass Transit service.

Boats, Contracts, and Service

The market should determine how many boat operators there

should be. The routes should be determined by the state. The suggestions have been that the State consider staggered contracts so all contracts don't come up at once. The contracts should be based on strict performance standards with penalty clauses for non-performance. The contracts should be examined at all times from a performance standard and not just a money standard. It has been agreed that the current formula works well which provides decreased subsidy as the number of riders go up. However, the request for proposals should be open to all boat operators in the future. The terms of those contracts should be further examined. Our Task Force heard a number of comments that they should either be three years with renewable options for another three, or five, or seven years. The seven years was mentioned because that is generally the time-frame for which a boat owner can go to a bank and get a loan.

Besides staggered contracts, the Task Force would like the State to look also at staggered service so that boats and buses are used throughout the day and not just in the morning and the afternoon. The question of jurisdiction was also raised by the Task Force. It was generally agreed that the jurisdiction should remain within the MBTA since having one department deal strictly with boats allows the operators to deal strictly with one person, rather than dealing with a number of departments having jurisdiction over routes, landside facilities, and finances. There was some discussion about what to do with competing jurisdictions, but it was felt that a water czar might not be the answer, since that would simply add one more layer of government involvement.

Marketing

The Task Force has several comments for marketing the boats. The boats may have been perceived as an alternative luxury service, compared to other forms of mass transit. One possible want to build the ridership on the boats is to make it more expensive for people to drive into Boston with parking surcharges. The State needs to get away from thinking that the boat ridership is off due to the economy. There is some indication that the ridership was off on the Hingham to Boston run at one point, when a third operator was brought in because the provider did not meet the terms of his contract. There is also a concern that the ridership is off due to the boat fares rather than the economy. The State needs to closely examine what the real opportunities presented by the Central Artery/Third Harbor Tunnel project are in order to make long-term commitments to not only the boats, but the buses, van pools, and other forms of transit in and out of Boston, realizing that with a depressed economy, fewer people are actually traveling to Boston each day. With fewer people traveling in, there may be less need to figure out ways to get people out of their cars, and yet cars are not the most effective way to move people in the future.

Opportunities to Privatize

There are a number of opportunities which have presented themselves to us. The MBTA is considering a new pass card system. This may be an area that could be privatized with bank debit cards. Amounts could be credited to the cards each month, and riders could then have their cards debited, regardless of whether they rode commuter rail, rapid transit, buses, vanpools or boats. Discount rates could even be programmed in for off-peak travel times.

Marginal routes and new routes should be considered as prime candidates for privatization. Information made available to the Transit Sub Committee indicates that Boston pays more per hour of operation of MBTA buses than in most other parts of the country. Those figures indicate that it costs $79.81 per hour to run a bus, excluding the capital costs in the MBTA system. On the lower end, Atlanta reportedly only pays $50 per hour, New Jersey pays $58 per hour, Houston pays $66 per hour, and New York City pays $78.81 an hour. Certainly more information could be gathered from Atlanta to see how they are able to accomplish a much lower rate per hour than Boston. Labor concerns could be addressed by attrition. New parking facilities could be privatized, and in some cases could be jointly developed with real estate developers.

There are opportunities but care should be taken to ensure that new service is not considered "predatory" either in pricing or by the service provided. Providing commuter rail service at a cheaper price to consumers than taking a boat or bus works against the boat and bus operators. So-called "complimenting" service should be carefully examined to make sure it is not predatory.

Privatization may also provide a chance to cut the number of state employees in some areas of transportation. It appears that there is a well-defined bureaucracy in place. Care should be exercised in guaranteeing that there is no duplication of services between agencies and departments. Privatized services could provide the state with more cost-effective service suited to the needs of people taking the service, and not to state agencies that provide the service.

In preparing Requests for Proposals, and reviewing unsolicited Requests for Proposals, the Commonwealth may want to look closely at contract language that speaks not only to the fitness of the contractor, but also their service implementation plan. Creativity, quality assurance, and cost effectiveness need to be encouraged. The contractor should state how it plans to meet the Transportation goals of the Commonwealth.

The Massachusetts Port Authority, for example, was very interested in how employees would be paid and what benefits were

available from the contractor to ensure a highly motivated workforce.

Conclusions

Finally, the Executive Office of Transportation and Construction is to be commended for allowing the private sector to participate in looking at opportunities for privatization. This may not have always been the case, and the private sector appreciates the opportunity to participate in this process, and hopes there will be more opportunities to work on public transportation policy issues.

We do not believe that a lot of additional studies need to be done to tie together the various modes of transportation. It is our belief that there are enough existing studies on how to move people. There is also enough expertise in the private sector to help put those studies together into a transportation framework that may be useful. Those studies should be worked into a transportation plan which moves this State away from a fragmented plan to a State Transportation Plan which will connect all of the various modes.

The State should also do all it can to make the private sector aware of contracts that may be coming up for all forms of service. This is now the case for minority owned businesses, and it should be expanded to all businesses that might be able to provide transportation services.

A Financial Restructuring Plan for the Massachusetts Bay Transportation Authority

About the Authors

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The Massachusetts Bay Transportation Authority (MBTA) is America's sixth largest public transit system and a critical element of the regional economy. It provides rapid transit, bus or commuter rail service for 78 member cities and towns within the greater Boston metropolitan area, as well as for 52 communities not currently within the MBTA district. While ridership, customer satisfaction, labor productivity and cost per passenger mile have all shown major improvements during the past decade, the MBTA's unique financial structure is increasingly dysfunctional. All major transit systems in the United States receive substantial subsidies, but no other system has as large a percentage of state general fund operating subsidy, as precarious a short term debt structure or as convoluted a budgetary process. Unless the MBTA's financing methods are fundamentally changed, they will almost certainly trigger another of the funding crises that have periodically threatened the system's operations in the past or, worse yet, could precipitate a credit crisis for the Commonwealth's borrowings and add tens of millions in additional interest costs for taxpayers at a time of fiscal distress.

The MBTA's Current Financing Structure and the Problems It Creates

During the past decade the MBTA has received a great deal of attention as one of the major so-called "budget busters" for the Commonwealth of Massachusetts. Although the MBTA has earned a reputation as one of the best-run mass transit systems in the country, it is easy to see why the MBTA's complicated financing structure has contributed to the Commonwealth's fiscal crisis when one looks at its income and expense statements for the past few calendar years.

Table 1: MBTA Income and Expenses by Calendar Year (in millions)

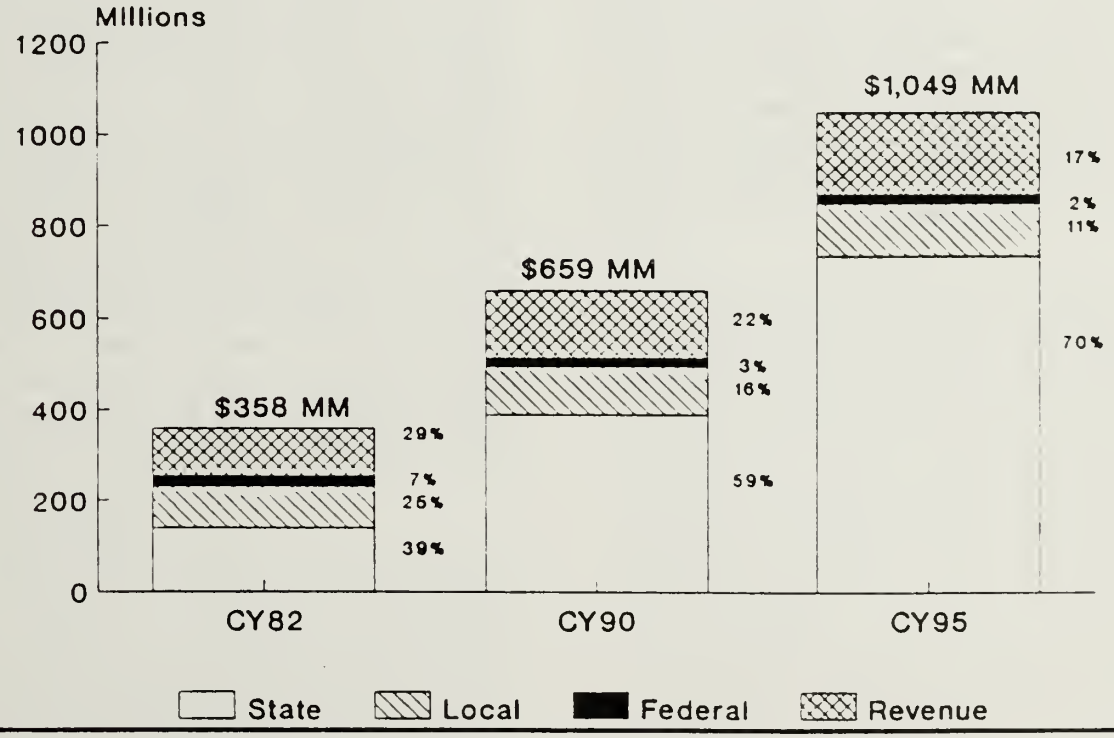
	1987	*1988*	*1989*	*1990*	*1991 (est.)*
Total Expenses	$511.7	$554.0	$604.4	$658.9	$720.9
Total Income	128.7	126.6	140.2	146.0	142.8
Expenses in Excess of Income	383.0	427.3	464.3	513.0	578.1
Federal Operating Assistance	18.8	18.7	18.5	18.3	18.1
Net Cost of Service	364.2	408.6	445.8	494.6	560.0
Local Government Share	98.7	101.1	103.6	106.3	107.1
Portion Covered by State	**265.5**	307.5	342.2	388.3	452.9

Compared to most other large mass transit entities throughout the country (and despite two rounds of fare increases in the past three years), the MBTA receives a substantially lower percentage of its operating funds from farebox revenues. A portion of the remaining funds is made up from certain other operating revenues, a small amount of federal operating assistance and assessments on member communities. However, the vast majority of required additional funding comes from direct Commonwealth subsidies characterized as "net cost of service" payments. The subsidy paid by the Commonwealth has increased much faster than the state budget as a whole, growing by over 70 percent during the past four years alone. This increase has not been matched by other funding categories largely because of assumed demand sensitivity to fare increases, dwindling federal assistance and a Proposition 2 ½-related statutory annual cap on total member city and town assessments of 102 ½ percent of the previous year's total.

The cap on member assessment increases has meant that the state-local split on net cost of service subsidies has shifted since the late 1970s from roughly 50-50 percent to 80-20 percent. In effect, this shift has added hundreds of millions of dollars to local aid benefitting the MBTA-served communities during the past decade. If there were an even split of costs between the Commonwealth and local governments on all MBTA subsidies (after federal operating assistance), the member communities would be paying an additional $172.9 million for this calendar year alone.

Between 1982 and 1990, the MBTA's total revenues from its own sources increased by 4.1 percent each year. During this same period, annual federal operating assistance dropped by 2.9 percent, MBTA member assessments increased at a 2.1 percent rate and *state assistance grew by an average of 14.1 percent annually—nearly seven times faster than the local share.* A major factor in the increase has been MBTA debt service, which grew 13.6 percent annually during 1982 to 1990. Because the state generally pays 90 percent of MBTA debt service and the federal government's contributions toward capital spend-

Figure 1: MBTA Funding Sources
(1995 figures projected)



ing have declined substantially, state debt assistance alone accounted for $136.2 million or 36 percent of the state's total MBTA funding during the last fiscal year.

If the MBTA's funding structure does not change, current projections call for the fiscal year 1996 state share to equal $716 million or over 70 percent of the MBTA's total budget at that time (and about 85 percent of the net cost of service). Figure 1 below demonstrates this dramatic shift in bearing the burden for increased transit costs.

Even though it now amounts to only slightly over three percent of total state spending and a number of measures have helped in controlling the recent growth in MBTA costs, the Commonwealth's rapidly increasing general fund contributions to cover MBTA deficits are both inequitable and a major budgetary problem. Of perhaps more immediate concern, however, are a number of other key elements in the MBTA's financial structure, including the following:

Use of the State's General Obligation Credit. Unlike every other major transit system in the United States, the MBTA cannot issue bonds backed by its own dedicated revenues. MBTA debt is essentially guaranteed as a full faith and credit general obligation of the Commonwealth. State laws, bond counsel opinions and a Supreme Judicial Court ruling all stipulate that the Commonwealth must immediately advance funds to pay any MBTA debt when it becomes due if the MBTA lacks funds to pay investors. The MBTA currently has $1.4 billion of outstanding long-term bonds, $262 million of refunding bonds and $335 million of short-term notes, all of which are rated at the same low level as the state and are using up the state's increasingly limited debt capacity. As discussed below, the use of the state's credit, especially for short term deficit financing, is both expensive and potentially dangerous.

Dependence on Short Term Debt. The Commonwealth and the MBTA have approximately $455 million in short term debt outstanding to cover MBTA funding requirements, most of which is cash flow borrowing to pay current and past operating deficits. Because these deficit borrowings are usually simply rolled over into new one-year note issues rather than being repaid, both principal and interest on the notes have grown rapidly over the years and have themselves contributed to the MBTA's growing deficit. Because there is a relatively narrow market for lower-rated notes and because the notes must be rolled over when they mature, such debt is particularly vulnerable to volatile interest rates and underlying credit problems. This past spring, the state's fiscal crisis came close to calamity when the MBTA experienced a temporary market access problem in rolling over a $175 million note issue. If the MBTA had defaulted on the outstanding note or had called on the state with little notice to repay investors with cash, the situation could easily have triggered credit rating downgrades to junk bond status for both the MBTA and the Commonwealth.

Retrospective Funding of Operating Subsidies. Since 1918, the Commonwealth has supported mass transit operations in the Boston metropolitan area by advancing working capital with cash or borrowed funds and later reconciling the accounts for local assessment or state subsidies once the actual deficit was determined. Because the MBTA's state and local subsidies are based on calendar year costs, the Commonwealth's appropriations are not made until the following fiscal year, which begins in July. The state's payments thus lag expenditures by up to 18 months (for example, the state appropriations covering the MBTA's 1990 calendar year subsidy are not made until Fiscal Year 1992).

The focus of the forward funding issue has been on increasing legislative oversight of the MBTA subsidies. (The MBTA itself already undergoes an elaborate operating budget process including the executive branch, its own board and the advisory board of local government members; capital budgeting is governed by the same legislative and executive branch requirements as for other state projects.) The Senate Ways and Means Committee, in particular, has repeatedly cited accountability and control problems the retrospective budgeting system creates for a large portion of the state's MBTA subsidies. A report by the Committee four years ago stated

that "... most of this funding is authorized after the MBTA has already incurred expenditures. With its retrospective budgeting scheme, the Authority manages to spend money during one calendar year and not call on the Commonwealth to help pay the cost until the following fiscal year. Although the MBTA spends hundreds of millions of dollars of state revenues each year, it is not held accountable to the Legislature or to the Administration." The roadblocks to reform have been the comparatively high near-term costs of shifting to forward funding by paying off or bonding out the outstanding MBTA and Commonwealth notes and funding the next year's state subsidies and local government assessments.

Service Provided Outside the Current MBTA District. While the entire Commonwealth derives benefits from the MBTA's services through economic growth, reduced air pollution and more efficient highway traffic, the direct availability of transit services historically has been concentrated within the MBTA district. With the system expansion during the last decade, however, many cities and towns outside the district are receiving direct services, particularly through the bus and commuter rail programs. Currently some 52 cities and towns with a total population of 1.5 million are outside the 78-member district, yet receive MBTA services (some of these are within one of the 15 far smaller Regional Transit Authorities). A number of communities on the South Shore will soon be receiving commuter rail with the return to service of the Old Colony line. In addition, thousands of residents of other nonmember cities and towns use the commuter rail stations in neighboring communities. The nonmember cities and towns are not assessed their fair share of the MBTA's local subsidy, they are not represented on the MBTA Advisory Board and their state legislative representatives do not have as direct an interest in MBTA-related legislation.

Financial Restructuring Plan

A financial restructuring plan for the MBTA should accomplish five primary goals:

1) Put the MBTA on a sound financial footing so that it is not faced with operating shutdowns, safety problems or declining ridership because of recurring funding and financial structuring problems.

2) Provide an equitable financing structure in which those benefitting from the MBTA's direct and indirect services pay their share of it costs.

3) Allow the financial flexibility to cope with growing service demands, new federal and state regulatory mandates (particularly the Clean Air Act) and the effects of regional economic volatility, while maintaining sufficient governmental oversight and control over a taxpayer-subsidized public service.

4) Protect the MBTA and the Commonwealth's credit and their other financing programs from potential harm by the burgeoning MBTA-related short term debt.

5) Insure that the best financing approaches and techniques from other major transit systems in the United States are used to lower costs, enhance revenues, minimize risks and guarantee the availability of needed capital.

Implementation of the following policy recommendations and enactment of a comprehensive package of necessary statutory changes should allow the MBTA to meet these goals in the near future and end its reputation as a budget buster for the Commonwealth.

Maximize MBTA Self-Sufficiency. Full privatization of most transit systems is not a realistic goal because they are unable to charge fares that even come close to recovering capital and operating costs, much less return a profit. All of the major transit systems throughout the United States require substantial public subsidies. Compared to these other systems, however, the MBTA receives a far higher public subsidy, in part because its operating costs, particularly for labor, are substantially higher. More importantly, the MBTA does not realize the level of own-sourced revenues that most other systems achieve. The main reason for these comparatively low revenues is a fare policy that trades off low costs for increased ridership and which provides high subsidies for the elderly, the disabled and students (who comprise over 20 percent of total passengers).

Nevertheless, the first step in restructuring the MBTA's finances is to intensify and accelerate the effort to control costs and increase operating revenues. While the MBTA has done a great deal in the past few years toward this goal, there remains much that can and should be accomplished. The list below is a summary of some major areas for additional focus:

- Capture the value of certain real estate assets (especially in the areas of the sale or lease of air rights, surplus property or rights-of-way).
- Allow for smaller but more frequent fare adjustments.
- Contract out additional services or renegotiate existing contracts to ensure competitive costing, particularly for commuter rail services.
- Enact legislation to better control certain costs such as tort claims.
- Promote increased ridership.
- Increase revenues from parking, concessions, rentals, fines, investments, advertising, merchandizing, increased fare compliance and other sources.

Unfortunately, while the potential cost savings and increased revenues from implementing the recommendations above could amount to tens of millions of dollars annually, even in aggregate they are unlikely to approach the levels necessary to solve much more than a small part of the MBTA's ongoing financing problems.

Bond Out the Short-Term MBTA-related Debt. Both the MBTA and the Commonwealth should bond out the short-term debt that currently funds deficit-related borrowings for MBTA operations. The existing tax-exempt commercial paper programs should be used for any short-term borrowing in anticipation of long-term MBTA capital debt issuance. Several other states that had grown dependent on rolling over large amounts of short-term notes each year for other purposes have recently decided to bond out their obligations. New York's program, for example, earmarks sales taxes to back long-term bonds that will take out $4.7 billion in accumulated short-term notes. From a credit perspective, this bonding out of MBTA-related short term debt would not constitute new borrowing—it simply would take existing debt that is growing out of control as it is repeatedly reissued and replace it with securities that are less vulnerable to market access risks and that would eventually be retired. This reduction in risk should have an additional benefit of improving the outlook for eventual credit rating upgrades for the MBTA and the Commonwealth.

It would even be possible for the Commonwealth to reduce average interest expenses if a long-term variable rate put bond structure can be used for the takeout bonds. (Tax-exempt bonds that re-set interest rates weekly have cost an average of one-half a percentage point less than one year notes during the past few years—an annual savings of over $2.2 million in interest on $455 million in debt.) If necessary for budgetary purposes, this bonding out could be accomplished gradually over time. On the other hand, if there were a sudden dramatic improvement in state revenues, a portion of the short-term debt might be taken out with cash. There would, of course, be an increase in cash flow costs during the near term as interest expenses are recognized in the current year and principal on the bonds is retired over time, but the benefits should make this approach worthwhile even in light of the Commonwealth's fiscal situation. As discussed below, it would also move most of the way towards forward funding of the MBTA.

Move Immediately or Gradually to Forward Funding. An April 1990 report by the MBTA entitled "A Catalyst for Economic Growth: Funding of Public Transportation in Massachusetts" responded to the state legislature's request that the MBTA develop a plan to move toward forward funding. The state senate's budget recommendations in 1988 had estimated that such a shift to prospective appropriations for the MBTA operating subsidy could save the Commonwealth $35 million in interest costs on short-term borrowing and nearly $10 million in foregone interest earnings on cash advances to the MBTA in fiscal year 1989 alone. The MBTA report concluded that forward funding in fiscal year 1991 would require $305 million to retire outstanding MBTA

notes, $317 to retire the Commonwealth transit notes and an appropriation of $381.5 million to finance both the state and local shares of fiscal year 1991 operating expenses pending reimbursement from local assessments.

The MBTA report analyzed two alternatives to implement forward funding: 1) issuing insured, fixed rate 10-year bonds to immediately retire the short-term debt or 2) increasing annual appropriations to repay the short-term debt over six years. The study concluded that 1) the added near-term fiscal burdens of either of these approaches would amount to over $50 million each year in net debt service for the first option and a net cost of over $94 million during the initial years of the second option; 2) either option creates accounting difficulties and the potential loss of nearly four percentage points in local assessment increases if District members are held harmless for the change in base years; and 3) the bonding option would not break even on a present value basis (i.e., begin saving funds after accounting for the time value of money) until fiscal year 2008 and the incremental option—though providing forward funding and cash flow savings by fiscal year 1997—would not break even until fiscal year 2007.

While the scenarios are accurate under their assumptions, they do not take into account the market access and interest rate risks incurred on the outstanding notes. There is a wide range of additional options using bonding and/or incremental funding that can be tailored to better meet the Commonwealth's current fiscal constraints. The near term costs could be considerably reduced by issuing longer term debt, deferring principal or incrementally funding over a longer period. The present value savings could be accelerated if the Commonwealth used a floating rate structure or interest rate swaps for most or all of the bonding. New York's bonding out of its accumulated $4.7 billion in deficit notes, for example, is planned to be issued in quarterly installments of approximately $400 million until September 1993 through the newly created Local Governmental Assistance Corporation. The initial transactions used 30-year maturities, and the state plans for future installments to include floating rate structures and other techniques to manage interest costs. The program earmarks a portion of the state's sales tax as a dedicated revenue to be appropriated for repayment of the bonds—a credit that has received A/A+ ratings.

Bonding out the MBTA-rated short-term debt or otherwise providing for all other subsidies already incurred would move nearly two-thirds of the way to full forward funding. The remaining element would be to shift the appropriation to the upcoming fiscal year, which could be implemented over time with incremental funding. The issue is perhaps best addressed in the context of providing a dedicated revenue stream and an independent credit for the MBTA, especially if it provides additional funds to supplement or fully replace the current state and local sources.

Provide a Dedicated MBTA Revenue Stream. Providing a dedicated revenue stream for the MBTA could help to achieve a number of important goals, including 1) eliminating or reducing the MBTA's dependence on the Commonwealth's credit, 2) setting an inherent limit on budget increases, 3) providing a vehicle for the District cities and towns to increase their funding share to a level commensurate with the services they receive and the power they wield through the MBTA Advisory Board, and 4) serving as a source for forward funding of the MBTA's budget. As an alternative to earmarking a dedicated revenue stream from existing Commonwealth general fund or transportation revenues, various new user fees or revenues could be implemented by the Commonwealth or authorized as local options to greater equalize the state/local cost sharing without increasing property taxes. To create an additional incentive for local governments, such revenues might include an additional amount for general fund purposes beyond the higher MBTA assessment. If a local government decided against using the local option source, it would have to provide for the increased assessment through current general funds.

Any of the revenues proposed would require legislation and most of the incremental revenues are likely to be politically difficult to implement. However, as discussed in the section below on the rationale for these restructuring recommendations, every other major transit system in the

while a five-cent increase within the current MBTA District would equal $60 million.

Parking fees have encountered significant political opposition in the past, yet could generate significant revenues. The Conservation Law Foundation recommended in April 1991 that a $50 per space per year fee be levied on all non-residential, off-street parking spaces in the MBTA service area, yielding $95 million (assuming 1.9 million spaces, as estimated by the Metropolitan Area Planning Council, with an exemption for governmental, high occupancy vehicle and "park and ride" spaces). The Foundation recommends that the proceeds be divided evenly with local governments. It calculates that this fee would add at most 20 cents per day to commuter spaces or two cents per hour on general commercial spaces.

The Foundation notes that as of 1989 Massachusetts ranked 47th nationally in the percentage of state tax revenue generated by motor vehicle users (5.5 percent of state tax revenues versus a 9.9 percent national average). Certain categories of motor vehicle-related user fee revenues seem to be the most promising both politically and economically for potential dedication to the MBTA.

Increase Cost Sharing with Local Governments. In conjunction with the provision of a dedicated revenue stream, especially if it is an incremental local option user fee, the legislation capping increases in the local share of MBTA subsidies should be amended. If the incremental or earmarked revenues total over $173 million, it would be possible to shift immediately to a financial structure in which local governments cover half of the total MBTA subsidy. If the revenues increase annually at the same level as do cost increases for the MBTA (and the MBTA is required to live within this budget), it should be possible to keep the state-local cost sharing balanced in the future.

Create a Stand Alone Credit for the MBTA. If a sufficient level of revenue is dedicated to the MBTA, it would be possible for the MBTA to issue bonds that do not require a pledge of the state's general obligation credit. If properly structured, the MBTA could achieve credit ratings in the A category, while restoring debt capacity or improving the credit of the Commonwealth. This would be the case particularly if the dedicated revenue stream included incremental revenues and/or earmarked funds that are not essential components of the general fund. In addition, the state should provide the MBTA with the authority to issue revenue bonds secured by revenues from its existing sources (parking, fare box, concessions, leases, etc.) and from projects it has scheduled such as the new garage at North Station (which might itself support up to $100 million in revenue bonding).

Expand the MBTA District. The Legislature should expand the MBTA District to include all those communities receiving or about to receive direct services from the Authority and should consider also including those communities in which a substantial percentage of residents commute to neighboring MBTA facilities. This is a matter both of equity and financial necessity. The estimated additional revenues from District expansion could range up to $11 million, according to a recent MBTA study. It would be important to insure that a revised assessment formula fairly allocate the costs according to the benefits received. The map on the following page shows the communities outside the District that receive MBTA service.

Restructuring the MBTA's Finances

The rationale for the proposed MBTA financial restructuring is that it would accomplish the goals outlined at the beginning of the plan. It would provide a sound revenue base, insure a more equitable cost sharing, allow flexibility and oversight, protect the state's credit and begin saving hundreds of millions in state taxpayers' dollars.

The expanding price tag for the MBTA's net cost of service to the state can be traced primarily to four factors: 1) the cap on local contributions imposed by Proposition 2 ½ and subsequent legislation that has caused a rapidly declining MBTA subsidy from local governments, 2) the decline in federal operating assistance, 3) the relatively low portion of operating costs recovered by the farebox, and 4) the lack of a stream of dedicated revenues to supplement the farebox. The discussion below focuses on a comparison of the MBTA's finances with those of other major transit

country now provides some form of dedicated revenues and most have a substantially higher locally funded component. Ideally, the financing structure could advance both environmental and transportation policy goals by employing motor vehicle user fees to increase MBTA ridership and maintain high quality services.

- **Sales tax.**

The sales tax is the most common non-farebox revenue stream used to fund mass transit. Some of the largest cities, including Atlanta, San Francisco, Los Angeles and Chicago depend on the sales tax to finance their capital programs, and are able to issue bonds rated in the "A" category based on sufficient debt service coverage and the tendency of sales tax revenues to track inflation and economic growth. The sales tax effectively links a transit system with the economic engine it helps to drive. Since the early 1970s, sales taxes have increasingly been established or increased on a regional basis to support major mass transit systems. In Massachusetts, each cent of the existing sales tax currently provides approximately $325 to $350 million per year and could increase to an estimated $425 to $450 million by 1997. The approximate amount of sales taxes collected within the present MBTA district is about one-half of the statewide total.

Compared to other states, the Massachusetts sales tax has a relatively narrow base with large categories of exemptions. For example, the *Report on Tax Expenditures* from the Appendix to the fiscal year 1992 Governor's Budget Recommendations estimates the fiscal year 1992 value of exemptions for sales of real property at $746 million, sales to tax-exempt organizations at $551 million, rentals of real property at $542.5 million, nontaxation of certain services at $463 million and sales of food at $396 million. While a sales tax increase or expansion of the base could provide an incremental revenue stream that tracks future MBTA costs, discussions with state officials indicate that it is probably not a viable alternative either economically or politically in the present circumstances. Earmarking a portion of the current sales tax is at least a possibility, but would be difficult to implement on less than a statewide basis.

- **Automobile use taxes (tolls, motor fuel tax, parking tax, motor vehicle fees).**

As policy tools, motor vehicle tolls, taxes and user fees encourage drivers to use mass transit. Through the fees, taxes and tolls, drivers help pay for the public goods they consume—clean air and road space—and contribute that amount to subsidize those who do not consume those goods. Use of this category of revenues for the MBTA would also assist the Commonwealth in complying with the Clean Air Act requirements.

Motor fuel taxes and motor vehicle fees secure many highly rated transportation bonding programs across the United States. Toll revenues are used by the Triborough Bridge and Tunnel Authority to secure bonds to help fund the New York Metropolitan Transportation Authority's capital program, and to fund contributions to the Authority for operating and debt service requirements. Massachusetts already levies a statewide gas tax, which was recently increased by ten cents per gallon. Revenues from tolled facilities in the MBTA District, such as the Tobin Bridge, the Callahan and Sumner Tunnels, and the Massachusetts Turnpike, are already pledged to existing authorities. The MBTA would face competition for additional motor fuel and toll revenues from the Central Artery/Third Harbor Tunnel project as well as from other transportation needs throughout the state. One proposal related to the Central Artery project would create a Metro Highway System, which would dedicate revenues including new and existing tolls and certain user fees within the Boston area to funding much of the regional highway infrastructure. This system, if implemented, could be designed to provide a subsidy to the MBTA from excess revenues.

A January 1989 MBTA Advisory Board study entitled *Financing MBTA Operating Costs: Alternatives for the Future* provided the following estimated yields for a variety of automobile use taxes or fees: 1) a 20-cent toll increase in the region would provide $25 million per year, 2) a 15 percent tax on parking in Boston would yield $25 million annually, and 3) a two-cent increase in the state gas tax would provide $50 million.

Table 4: Dedicated Taxes for Operating Revenues among the Largest Transit Systems (Percent of Total Revenues)

	Total Dedicated Taxes	*State*				*Local*		
		Sales	*Gas*	*Tolls*	*Other*	*Sales*	*Gas*	*Mortgage*
San Francisco (BART)	50.7	0.2				50.5		
Atlanta (MARTA)	46.7					46.7		
Los Angeles (SCRTD)	45.5			0.1		45.4		
Chicago (CTA)	41.5					41.5		
New York (NYCTA)	32.2	19.7		4.5		3.5		4.5
Philadelphia (SEPTA)	13.5				13.5			
Boston (MBTA)			None*				None	

* Fifteen percent of gasoline tax revenues is allocated to the state general fund for appropriation for mass transportation.

Source: American Public Transit Association, transit agency financial statements and discussions with transit agency officials.

$135 million annually for SEPTA and $65 million for other transit systems in Pennsylvania.

The primary dedicated revenue source among the major systems shown in table 4 is the sales tax. The sales tax provides almost all of the non-farebox revenues of systems in Chicago, Los Angeles, San Francisco and Atlanta, as well as for other large systems in Dallas, Seattle, Houston, St. Louis, Denver and Cleveland. The New York City Transit Authority, an affiliate of the MTA (Metropolitan Transportation Authority), relies on a wide variety of revenue sources to supplement the farebox. These include a ¾ percent tax on the gross receipts from sales of petroleum products; a ¼ percent surcharge on New York state's personal property and service sales tax within the MTA district; two taxes imposed on trucking, telegraph and telephone companies; and taxes on recorded mortgages in the MTA district. The Transit Authority also receives a majority of the operating surplus of another affiliate, the Triborough Bridge and Tunnel Authority, which operates nine bridges and tunnels in New York.

These large transit systems also depend on dedicated revenues to assist in funding their capital programs. MBTA, with no dedicated funding, relies solely on state and local assistance and bonds backed by a general obligation pledge of the Com-

Table 5: Revenue Bonding Programs Secured by Dedicated Revenues

	Revenues	*Ratings (Moody's/S&P)*
New York (MTA/NYCTA)		
TBTA Revenue Bonds	Tolls	Aa/A+
TBTA Subordinated Lien Bonds	Tolls	A1/A-
MTA Transit Revenues Bonds	Fares and other revenues	Baa1/BBB+
Chicago (RTA/CTA)	Sales Tax	Aaa/AAA (insured)
Los Angeles (LACTC)	Sales Tax	A1/A+
San Francisco (BART)	Sales Tax	A1/A+
Atlanta (MARTA)	Sales Tax	A1/A+

Source: Moody's Investor's Service and Standard & Poor's.

systems throughout the United States. The comparison shows that the MBTA's financing structure is in many respects considerably different from other systems and increasingly outmoded.

Since 1982, the share of MBTA costs borne by the 78 cities and towns in the MBTA District has declined from approximately 25 to 18.5 percent. As table 2 shows, the average local assistance among all U.S. transit systems in 1989 was significantly higher, at 33.3 percent.

Table 2: Mass Transit Revenue Sources

	Operating	*Local*	*State*	*Federal*
All Systems 1982	43.0%	(44.5% combined)		12.5%
All Systems 1989	41.8	33.3	18.7	6.2
MBTA 1982	29.0	25.0	39.0	7.0
MBTA 1989	23.6	18.5	54.5	3.4

Sources: American Public Transit Association and MBTA.

Table 2 also shows the trend in federal operating assistance, which declined for all mass transit systems from 12.5 percent in 1982 to 6.2 percent in 1989. Federal assistance to the MBTA now covers only about 3.4 percent of costs, down from 7 percent in 1982 and from a 10 percent peak in 1978. While federal policy is moving toward increased flexibility in how transportation grant allocations are used by the states, there is little expectation that the MBTA or other transit systems will be able to look to Washington for additional federal operating subsidies. The Commonwealth should, however, lobby strongly for increased federal transit funding to seek a greater share of existing federal monies.

Recovery of costs from the farebox is a policy matter as much as it is a financial one. Operating revenues from all sources constituted 23.6 percent of total MBTA revenues in 1989, as shown in table 2. Following a fare increase implemented in 1989, the "farebox recovery ratio" increased to approximately 30 percent. (The legislature now mandates that the MBTA recover one-third of operating costs including federal assistance. The MBTA complied with this requirement in 1990.) For all other transit systems, the average recovery ratio is 42.6 percent. Table 3 shows a comparison with transit systems in other major cities. The MBTA's recovery ratio is the lowest among these systems, even after adjusting for the recent fare increases.

Table 3: Revenue Sources among the Largest Transit Systems 1989

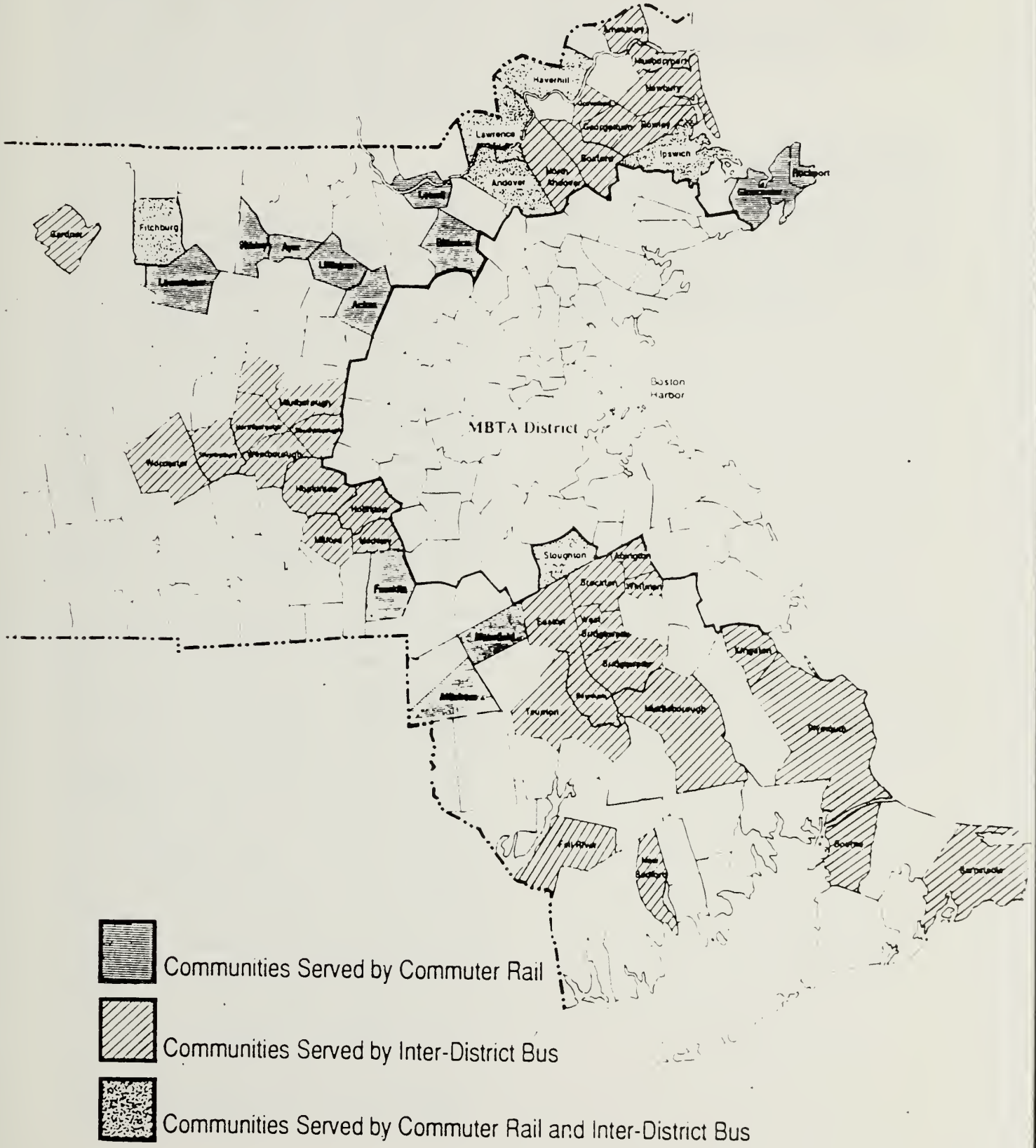
	Operating	*Local*	*State*	*Federal*
New Jersey (NJ Transit)	55.4%	0.1%	36.4%	8.2%
Chicago (CTA)	49.4	42.2	2.0	6.4
New York (NYCTA)	48.9	24.6	24.2	2.3
Atlanta (MARTA)	47.9	46.7	0.1	5.4
Philadelphia (SEPTA)	45.4	12.0	37.6	4.9
Los Angeles (SCRTD)	45.3	45.4	0.1	9.2
San Francisco (BART)	44.5	55.2	0.2	0.0
Washington (WMATA)	44.5	29.1	17.4	9.1
Boston (MBTA)	23.6	18.5	54.5	3.4

Source: American Public Transit Association, *1990 Transit Operating and Financial Statistics*.

Table 3 also demonstrates that subsidizing transit fares is an accepted use of public monies. According to the American Public Transit Association, the primary public benefits of mass transit include 1) energy conservation—for every 10 percent of urban commuting trips replaced by transit nationally, 300,000 barrels of oil are saved each day; 2) pollution reduction—the single person automobile emits 15 grams of carbon dioxide per passenger mile and 2 grams of nitrogen oxides, compared to 0 and 0.5, respectively, for rail transit; 3) mobility for the disabled, the elderly, the young and the poor; and 4) congestion reduction—every bus full of passengers removes 40 cars from traffic and every full rail car removes 75 to 125.

MBTA and SEPTA (Southeastern Pennsylvania Transportation Authority) were the only two major U.S. transit systems in 1989 without dedicated taxes or other revenues to supplement fares and local, state and federal grants. Now MBTA stands alone. In August 1991 Pennsylvania established five sources of dedicated funding for SEPTA: a $1 fee on new tires, a 6 percent sales tax on magazine purchases, a 3 percent motor vehicle lease tax, a $2 daily motor vehicle rental fee and an increase in the public utility realty tax. These sources together are expected to generate over

Figure 2: MBTA Service outside the District



Communities Served by Commuter Rail

Communities Served by Inter-District Bus

Communities Served by Commuter Rail and Inter-District Bus

monwealth. Comparable systems have established revenue bonding programs secured by the dedicated funds, shown in table 5. These bonding programs enable the transit systems to issue bonds rated independently of the state's or local government's general obligation rating. The state and local government's ratings and debt capacity are in turn independent of the transit system's operating and capital programs.

Conclusion

The recommendations proposed here for restructuring the MBTA's finances will not be easily implemented. Major public institutions function as they do because of political decisions made over time in the light of unique geographic, historical, social, economic and demographic circumstances. These decisions determine who will receive and who will pay for specific public benefits such as those provided by the MBTA. Decisions that were made during the past few decades have made the MBTA—after an enormous amount of effort and funding—one of the best-operated transit systems in the country. The system has increased ridership by 23 percent since 1982 and now carries 660,000 passengers each working day, including one half of all trips into Boston's central business district.

As discussed in this report, however, the financial structure of the MBTA is unsound. At a time when it will face large additional funding requirements to help the Boston area cope with stringent new Clean Air Act standards, potential dislocations from the Central Artery and Third Harbor Tunnel projects, expanding service and equipment demands and an economy that has hurt Massachusetts taxpayers' and transit customers' ability to pay, the MBTA needs the statutory and policy tools to put its financial house in order. While it is politically difficult to further reduce costs, begin to repay an accumulated deficit, provide additional revenues, revise long-standing fiscal practices and reallocate the financial burden, the viability of the system will be jeopardized if these measures are not taken soon. Because many of the problems and their solutions are interrelated, it should be easier to tackle these issues with a comprehensive package of legislation to reform the MBTA's finances than to seek piecemeal solutions in spending caps or arbitrary requirements on revenue percentages.

Our discussions with executive and legislative decision makers in the Commonwealth indicate that there is an acute awareness of the problem and a growing desire to provide a long-range solution. We hope these recommendations are helpful in leading to such fundamental reforms.

The authors would like to thank the many people at the MBTA, the Executive Office of Transportation and Construction, the MBTA Advisory Board, the Executive Office of Administration and Finance, the Governor's Office, legislative committees, and civic, legal, financial and consulting organizations, without whom our analysis for this plan would not have been possible.

HIGHWAY SERVICES SUBCOMMITTEE

FOREWORD

Many studies have been done that provide considerable evidence that transportation spending has a positive impact on the long-term development of a region's economy; however, recent studies also indicate a broad based slump in public investment in infrastructure projects by as much as 50 percent. In the meantime, demand for transportation facilities climbs unabated. From the many writings, one of the more apparent conclusions is that the funds that exist to enlarge or maintain a transportation network should be managed properly to deliver maximum service cost effectively. Public officials charged with the operation of transportation agencies are responsible, more than ever before, to see that all ideas on how to most efficiently operate their departments are developed. In Massachusetts, considering the state of the economy, efficiency in operating public transportation departments is a major concern due both to the lack of available funds and the historical emphasis on using transportation projects as pump primers for economic recovery. In the recent past, there has been an increased emphasis on various alternatives to public spending that shift traditionally public services to the private sector. The report that follows attempts to provide guidance to the Commissioner of the Massachusetts Department of Public Works and the Secretary of Transportation in their consideration of alternatives to providing the traditional services of the Department.

SUMMARY

This report presents the comments, ideas, and recommendations of the Services Subcommittee of the Privatization Task Force. The subjects discussed illustrate the wide scope of the subcommittee's deliberations.

In general, the subcommittee suggests that various forms of privatization may be applicable to the Department, or to a newly formed state Department of Transportation. The subcommittee also cautions that a careful evaluation be made of the overall impact of any privatization initiative on a Department with limited resources and far-reaching responsibilities.

A background section describes the historic stance of the Department with regard to privatization. In addition, this section discusses the legal structure of the Department and Federal considerations regarding privatization in the DPW. In addition to general recommendations made throughout the report, the subcommittee has listed specific areas for further study before any privatization initiatives are implemented, and specific projects to be considered.

BACKGROUND

THE COMMITTEE

In May 1991, a Privatization Task Force was assembled to study the various aspects of privatization and their effects on the major transportation agencies of the Commonwealth. This task force was divided into four subcommittees. This is the report of the Services Subcommittee. The members of this subcommittee are individuals with various backgrounds -- engineers, lawyers, planners, accountants, business owners and MDPW employees -- management and labor.

These individuals, for the most part, did not represent special interest groups. They certainly used their backgrounds to the advantage of the committee; however, they provided their input without specific reference to any business or fraternal association. The subcommittee considered itself a group of citizens interested in government.

The subcommittee focused its attention on the Massachusetts Department of Public Works. Meetings were held bi-monthly from June 1991 through November 1991. Although meetings were formally posted and conducted in an orderly fashion, the input by committee members was informal and accepted without formal motions, etc. The subcommittee maintained the

posture of an advisory group interested only in developing recommendations for the Secretary of Transportation.

The subcommittee was fortunate to have various members of government make formal presentations on issues pertaining to privatization and the workings of various administrative Departments in Massachusetts. Details of these presentations are available in the minutes of meetings attached as an appendix to this report. These presentations, along with the numerous contributions by all members, have provided the basis for the recommendations of this report. In addition to the dialogue at meetings and the various presentations, the subcommittee was the recipient of many publications on various forms of privatization and case histories throughout the U.S. and abroad. Much of this information was provided by the Secretary's office and the Commissioner of the MDPW who, throughout these deliberations, has been an invaluable resource. The reports along with all background material are identified in Appendix A.

MDPW PRESENT STATUS

It is important to note that the MDPW presently acquires many services from the private sector. In comparison to similar departments throughout the U.S., it is considered one of the most "privatized" departments (see graph Appendix B). Services provided by the private sector include many of the traditional highway maintenance functions as well as engineering,

design, and construction inspection services. It is also important to note that due to the organizational structure of the Department, i.e., eight distinct geographical districts there is no consistency in whether services are provided by private vendors or MDPW personnel. This organizational structure is of particular concern given to the recommendations of the committee. This structure also makes it difficult to understand the present capabilities of the Department and almost impossible to develop honest productivity levels (efficiencies) for the various highway maintenance services. A considerable amount of time was spent by the subcommittee on understanding the service requirements and standards of the Department. It is apparent that each district has its own needs and standards. Much of this variation is due to the geographic location of the particular district and cannot be avoided. The result of differing organizational structures, needs, and standards is that privatizing a service for one district may be the most economic approach, while the same approach in another district may result in disaster.

It should also be noted that the MDPW is not similar in structure or size to the other transportation agencies being studied, i.e., Massport, MBTA, MTA. The MDPW is subject to legislative oversight whereas the Authorities are more autonomous. In addition, the MDPW is responsible for <u>all</u> 12,000 miles of highways throughout eight districts, whereas the Authorities are each responsible for a smaller, more specific area of concern and services related to that specific area. Privatization efforts at the MDPW will require changes in legislation and management procedures.

FEDERAL CONSIDERATIONS

Equally important as the present organizational structure of the Department relative to privatization is the relationship with and requirements of the Federal Highway Administration. Requirements associated with federal funding vary from highway to highway depending on the original agreement for its construction. Restrictions on earning revenue from assets originally paid for with federal funds are of major concern, especially when considering development projects for un-used highway land parcels. In some instances revenues will have to be shared with the Federal Highway Administration in the same proportion as the original grant for construction. However, a review of the present federal highway bill indicates these federal requirements have been changed to the favor of the Department. It is important to note that these requirements still have a definite impact on the ability of the Department to generate revenue from its land assets. To a lesser degree, federal requirements on safety, highway design and maintenance will also have an effect on overall efficiency that may be realized from better management of existing resources. It is fair to say that future projects should evaluate the overall impact of federal assistance. What may appear as a good construction grant may require design parameters and maintenance requirements that outweigh the benefits of the original federal grant.

LEGAL STRUCTURE

Presently, any revenue received by the Department is returned to the Commonwealth's General Fund. Although the Asset Management Board (AMB) has the ability to direct up to 50 percent of revenues received on development projects to the initiating Department, any revenues received by the Department at this time would not be directed to transportation projects or the betterment of the Department. In considering various forms of privatization, that may reduce Department spending, there is a desire to see the savings revert to the Department's account rather than the General Fund. Time did not allow for the subcommittee to outline the changes required in the legal structure under which the Department operates. It is apparent that the Department needs additional funding to better maintain its facilities. There was discussion as to how the present process directly ties the Department's funding and priorities to the legislature. State transportation Authorities -- MBTA, MTA, Massport -- have a definite advantage over the Department in directing revenue and cost savings back into their individual accounts. Authorities are also structured in a way more receptive to an enterprise accounting system.

SUBJECTS DISCUSSED

The subcommittee discussed numerous subjects ranging from the organizational structure of the Department to the details of how contracts are administered. These subjects can be

summarized into four major areas:

- MDPW Structure and Management
- MDPW Services
- Various Forms of Privatization
- Development Projects/Real Estate

This section of the report presents a general summary of these discussions. Throughout the discussions, various facts were presented and developed that have a significant bearing on the prospect of privatizing certain elements of the Department. In an effort to make recommendations that could be implemented, the subcommittee devoted considerable time in understanding the Department, its services, various forms of privatization, and the idea of utilizing excess property to generate income. Combining all of these discussions has helped the subcommittee shape realistic suggestions that could be implemented with little or no change to the present structure of the Department.

MDPW ORGANIZATIONAL STRUCTURE AND MANAGEMENT

The Department employs approximately 3,000 employees. There are numerous job descriptions ranging from professional senior management types to detail service, craft labor types. The Department has contracts with labor unions to provide both professional and

non-professional labor. These contracts contain provisions that must be given serious consideration before any service being performed by these labor units could be privatized. In essence, the Department has already contracted for many of these services -- with the unions. The Department owns considerable equipment, including automobiles, trucks, loaders, cranes, barricades, signage equipment, painting equipment, etc. Consideration must also be given to how this equipment will be utilized if a task is privatized. The Department has eight districts that maintain the highways throughout the Commonwealth. In many ways these districts are as similar as they are different. In the service area, which is largely the responsibility of the districts, privatization will be difficult because of the differences that exist in the districts. The most important differences in regard to privatization are the performance standards and the actual makeup of the labor force at each district. Additionally, the Department has recently invested in upgrading the skill level of many employees. Any privatization effort should not mean the loss of that investment.

The complexity of the organizational structure of the Department is probably best described by the fact that a 64-page booklet, entitled "Organizational Guide", is needed to explain it. From discussions, it appears that divisions have overlapping responsibilities and district offices operate almost as independent entities. The present structure does not yield easily to privatizing services or tasks.

The management structure of the Department is equally complex. There were many discussions concerning the "red tape", "procedures", "contracting requirements", etc., all of which appear to impede the process of getting work done. From the discussions, it is evident that management responsibilities are spread out almost horizontally, with very little centralization. This makes it very difficult to evaluate the existing performance of the Department. In looking at areas to increase efficiency through privatization, it is important to know what the existing productivity level is for a particular task. There does not appear to be good information on productivity levels, whether for the Department's employees or for the services provided by the private sector. The number of variables that exist due to Department structure, geographic location, performance requirements and standards of the districts, etc., makes it difficult to select those services and tasks that would be good candidates for privatization. The subcommittee has included specific suggestions on tasks that could be considered for privatization.

MDPW SERVICES

The basic service of the Department is to engineer, design, construct and maintain a safe network of highways throughout the Commonwealth. Engineering, design and construction services are provided mostly by the various divisions, i.e., Highway Engineering, Right of Way, Construction, and Highway Maintenance. Actual maintenance of the highways and local permitting is provided by the District Operations.

The history of the Department is to have many services performed by the private sector. Many tasks are individually awarded and contracted; as a result, each task requires a discrete contract, and produces wasteful administrative contracting expenses. Despite the fact that it would require legislation to implement a change, this subcommittee believes that an effective way to consolidate spending would be to combine the private sector engineering, design, and construction services into a total package, including performance specifications, paraphrased as "Design Build". Repair and maintenance procedures of the Department could be retrofitted into this same total package concept as those governing new work.

Another task of the MDPW is to prequalify private contractors to perform work for this agency. In the Commonwealth today, the transportation and building agencies of the state (e.g., DPW, MDC, MBTA, and DCPO) generally have their own prequalification departments. Private general contractors in the Commonwealth provide a wide range of construction services for each of these agencies. It is our opinion prequalification should be consolidated into one agency for all work within the Commonwealth, this eliminating wasteful spending of ever diminishing tax dollars. To avoid the appearance of bias perhaps this prequalification agency could come from an independent source from the private sector.

In the maintenance service area, all services were discussed; i.e. lawn mowing, snow plowing, catch basin cleaning, road patching, fence repair, street sweeping, etc. This area is confusing due to the variances in the eight districts. There appears to be no good information on

performance standards of the private contractors or the Department's in-house personnel. The quality of these services varies tremendously. It was stated that the Department personnel take considerable pride in their work, whereas the private contractor, although interested in quality, is bound by the numbers. It was also stated that the management oversight, and inspection of these privatized services was inconsistent and performance could not be verified.

VARIOUS FORMS OF PRIVATIZATION

The subcommittee discussed three basic forms of privatization and agreed upon general definitions of each. It is extremely important that the public sector fully understand the value of the public asset. Public assets take many forms i.e., property, equipment, labor force, permits and the many forms of the developed infrastructure. The three basic forms are Full Privatization, Public/Private Partnerships, and Public/Public Partnerships.

Full Privatization - Full privatization has a total service, including labor, equipment, and supervision, performed by the private sector for an agreed upon fee. There are no assets required by the public sector. The public sector specifies the performance requirements, inspects the completed service, and delivers payment.

Public/Private Partnership - A public/private partnership has both the public sector and the private sector combining assets to accomplish a task. Each entity in the partnership also shares the risk of the venture. A simple example would be the private sector providing labor and the public sector providing equipment to accomplish a task. This arrangement is most efficient when the public sector uses the assets it has accumulated over the years to their full advantage, and can result in the maximization of public assets.

Public/Public Partnership - A public/public partnership has two public agencies combining assets or resources to accomplish a task. These relationships can take many forms. Local agencies can join with state agencies, state agencies can combine with other state agencies, and state agencies can combine with Authorities, etc. It is important that both entities have common goals and share in providing resources in an agreed upon proportion. There should be many opportunities within the EOTC to develop public/public partnerships that could result in more efficient operations for the overall transportation sector in Massachusetts. For example, snow plowing of isolated sections of municipal roadways within the state highway network should be plowed by one agency, not both; gap funds for downtown areas in the state highway system should be provided to municipalities; drawbridge operations should be evaluated to find more locally responsive coverage rather than round the clock. In addition, there is a case for municipalities to assume the burden of maintaining local roadways off the major highway system that were built and have been maintained by the Department for many years, e.g., Highland Avenue in Needham and Dover.

Throughout this report, privatization in one of the forms mentioned above has been suggested as a way to increase efficiency and reduce costs. Each of these forms may require changes in legislation or procedures as to how tasks are completed. Existing Massachusetts laws are not written to readily accept privatization of contracts. Ownership of assets, commingling of revenues and assignment of liabilities are a few of the areas that require language not normally used in Massachusetts contracts.

DEVELOPMENT PROJECTS

The subcommittee devoted considerable time to discussing various development projects. There was general agreement that the Department is the custodian of many valuable parcels of property. In some instances these properties are underutilized. Many district offices or maintenance garages or yards are located in areas that have been developed over the years. These properties have increased in value and in some instances are considered prime real estate. The AMB of the Commonwealth has the authority to allow Departments to lease state property for a period of 99 years. Up to 50 percent of the revenue realized from such an agreement can be directed to the account of the particular Department and the subcommittee recommends all of this be directed to the Department. The subcommittee realizes that these types of projects may require relocation of existing facilities and services; however, this is one area where revenue may be realized by the Department. Properties

under the care and custody of the Department should be evaluated for development potential only after the cost of relocation of the current services has been considered.

There was also considerable discussion of leasing rest areas on some of the primary highways. Considerations on use include restaurants, automobile service centers, parking facilities for other modes of transportation and storage areas or facilities. These areas are subject to many conditions contained in the original agreement with the Federal Highway Administration covering grant monies for construction. The proposed re-authorization of the Federal Highway Bill may provide relief from some existing contract conditions. The subcommittee also considered the Department's properties that have been developed into park-and-ride facilities for bus and rail patrons. Where these properties remain under the control of the Department, consideration should be given to developing service centers and possibly a charge for parking. This would require inter-agency agreements and coordination.

It was also suggested by the subcommittee that the Department owns parcels of property that would be attractive to the private sector for development into parking garages.

AREAS OF FURTHER STUDY

Along with the recommendation for specific privatization projects, the subcommittee believes it is important to identify general areas where further study or data is required prior

to implementing actual projects. Needless to say, there are many questions that remain unanswered concerning privatization in Massachusetts. This section of the report identifies these general areas and recommendations concerning further study. These areas include:

- Implementation of the task force recommendation
- MDPW management
- Performance standards
- Department services
- Forms of privatization
- Property development

IMPLEMENTATION

It is apparent to this subcommittee that the Department is responsible for the transportation network that links all of the authorities. The Department's present structure, i.e., eight districts, would serve well as a structure for a DOT. Although this may appear to be a bold step, we believe, as individual recommendations from all subcommittees are evaluated, the total impact on all transportation groups should be considered. It makes sense to study the idea of having one source implement all recommendations for the overall benefit of the State's entire transportation network. The other subcommittees studied very small portions of the State's total transportation network. The MBTA, Massport and MTA all are very

different agencies from the MDPW. With the resources of all transportation agencies working together, the State has the framework needed for a DOT where state-wide planning can provide for overall needs as well as the individual needs of regional agencies. In addition, the legal structure of the State should be reviewed. From experiences related to the subcommittee, it is clear that Massachusetts State Law was not written to accommodate the legal requirements of the various forms of privatization. Other states have passed legislation that deals specifically with privatization. The Department's legal structure should also be reviewed. Adjustments in State law should include changes for all transportation departments or agencies to establish a DOT.

Every study committee at the beginning of their report makes a strong case for continuing their efforts or implementing their recommendations. This subcommittee is no different. We do believe a position in EOTC should be created to implement the recommendations of the entire task force. A study should be done on how best to implement these recommendations for the benefit of the State's entire transportation network. It is time to consider the development of a Department of Transportation for Massachusetts. This would complete the intent of the development of the EOTC. The task force report could serve as the catalyst to complete the full development of a DOT. It is important that revenues derived from privatizing transportation functions are directed to the benefit of transportation and not the General Fund.

MDPW MANAGEMENT

Throughout the proceedings, the subcommittee discussed many aspects of the Department's present management structure. A study should be done to assess how the present management would administer privatization projects. Projects could be administered by headquarters or the district offices. The study should also consider what levels of management are required to properly manage private contractors. The concept of privatization requires direct supervision of the private contractors with well-defined responsibilities and appropriate authority so as to effectively manage them.

PERFORMANCE STANDARDS

It is important to understand the existing level of productivity for the individual tasks recommended for privatization. The subcommittee found variations by district and by contractor for similar jobs bid out to private contractors and could not account for the differences. Productivity levels should be developed prior to privatization so that Department management knows where the existing work force performs well and where there is room for improvement, possibly through a form of privatization. This study should evaluate similar tasks in each district to determine where improvements can be made and how service tasks should be privatized; e.g., by district or across the entire Department. Where applicable, performance standards should be considered to maintain reasonable

levels of productivity. Union contracts should be reviewed so as to determine the best way to implement performance standards. A good understanding of where existing personnel are achieving high levels of productivity and where productivity is lacking will be invaluable information in a privatization program.

DEPARTMENT MAINTENANCE SERVICES

The subcommittee discussed privatizing the Department's basic maintenance services. Information should be assembled and evaluated on how each district is providing these services. A matrix should be developed with the service on one axis and the District on the other axis. Symbols could show which services are privatized and which are being performed by Department personnel. Comparisons should include price differences, jobs performed/not performed by contractors and Department personnel and some rating for the type of road being serviced. The districts should also provide information on the performance of private contractors and any particular reason why their district should or should not privatize.

FORMS OF PRIVATIZATION

There are four steps in the privatization of any services, facilities or operations. These are:

- Defining the need
- Selecting the provider or providers
- Developing the contract
- Monitoring delivery effectiveness

Information is needed on the various forms of privatization and how they would fit with the Department. Information should be gathered on what services are available from private contractors and at what cost. These may vary from district to district. Cities and towns should be solicited for their interest in providing services under a public/public partnership with the Department. Equipment lists and availability of equipment should be developed to be used in public/private partnerships where the Department provides the equipment and the private sector provides the labor. The union agreements in place should be reviewed to see if the existing employees of the Department can competitively bid for tasks. In some instances the Department may want to conduct trial projects to develop information on how the various forms of privatization would work. Results of these case studies should be closely monitored by senior management.

PROPERTY DEVELOPMENT

The subcommittee believes further study should be done on the property under the control of the Department. Lists of available property that could be used for development should be formed. These lists should include maintenance and district headquarters facilities now located in developed areas. They should also include roadside rest areas for park-and-ride centers and possible automobile service centers. The Department should also list all properties that are being used by other state agencies. Development opportunities include parking garages, office space, park-and-ride facilities, commercial space, design/build projects, etc. The lists of available property should be developed with these types of projects in mind.

SPECIFIC PROJECT RECOMMENDATIONS

The subcommittee has developed specific project recommendations. These recommendations are made with the knowledge available to the subcommittee at this time. Once the further studies recommended earlier are complete, some of these specific recommendations may not be applicable. These specific projects are detailed on individual pages of this report contained herein. The subcommittee established the criteria and an outline to describe these projects. The form used for these individual projects along with the individual project description are attached in this section.

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

PROJECT DESCRIPTION

- Type of Service - Land Development , etc.
- Type of Contract:
  - Full Privatization
  - Public/Private Partnership
  - Public/Public Partnership
  - Consolidation of Department Services
- Details on the Type of Company or Public Entity That Would Participate
- Design/Build Type Project

COST SAVINGS

- Explain the savings to the MDPW (or Commonwealth) that would result from this project
  - Manpower - consider all costs of labor
  - Costs - budget items, expenses, bonding, etc.
  - Time - schedule of projects, etc.

ACTION REQUIRED BY COMMONWEALTH

- Administrative Action by MDPW Commissioner
- Executive Action by Governor
- Action By Asset Management Board (AMB)
- Change in State Law
- Departments or Districts Affected (if possible)
- Change in Union Contract
- RFQ/P Development
- Federal - State - Regional - Local Approvals

ADDITIONAL PROJECT DETAILS

- Requirements of Private Sector-Bonding, etc.
- Additional Advantages of Project
- Special Provisions - State Agencies involved, etc.

SCHEDULE

- How long will it take to implement this project? (Years - months - weeks) -- Best guess
- Will it effect this year's budget? 7/91 - 7/92

IMPLEMENTATION RESPONSIBILITY

Who should implement this project?

- MDPW Commissioner
- Executive Department - Governor
- Legislative Committee on Transportation
- Other State Agency - AMB

Project Submitted by: _____

Date: _____

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

Value Engineering

- [ ] Revenue Generating Potential
- [x] Better Management of Current Resources
- [x] Better Contracting Practice
- [x] Privatization Potential

PROJECT DESCRIPTION

Apply value engineering principles to all MDPW activities specifically:

- All projects during design phase.
- All current MDPW standards; General Specifications.

COST SAVINGS/GENERATING

- Potentially $1,000,000/year.

ACTION REQUIRED BY COMMONWEALTH

- Commissioner directs operating groups.
- Chief Engineer/District engineer implement within their area.

ADDITIONAL PROJECT DETAILS

Value engineering is presently applied at construction state. To gain greater value, it needs to be applied at earlier stages. See attached article.

A firm could be selected to do the VE and to implement findings.

SCHEDULE

Should be in full operation within six months to a year.

IMPLEMENTATION RESPONSIBILITY

- Chief Engineer
- District Engineer

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

EVERY PENNY'S WORTH

ALPHONSE DELL'ISOLA

Value engineering has been used in the construction industry since the 1960s, but highway projects have sometimes been thought of as 'too simple' for VE studies. Now, with the increasing complexities of highway megaprojects, state agencies are embracing the system and reaping handsome dividends. For relatively little investment, VE can yield millions of dollars in savings without sacrificing project quality.

A team of technical specialists—a highly respected group with impeccable credentials—has gathered to brainstorm about a proposal for a major highway expansion. The questions fly: Is the selected design the best one for this project? Is this overpass really necessary when only 200 cars per day will use it? What should the strength of the concrete be and should it include additives? Should a construction manager be hired? Before its work is done, the team will analyze and scrutinize everything about the project—all the cost drivers, from the schedule to the materials and construction methods.

The group is engaged in value engineering (VE)—a system designed to get the most out of the project dollar without jeopardizing quality. The process is relatively quick, about one week for a study and recommendations. Moreover, state highway agencies—through a team of outsiders not associated with the original design—can take an exhaustive "second look" at all aspects of their projects.

The recent results in the transportation sector have been impressive, and in some instances, spectacular:

- In Phoenix, two freeway interchanges were projected to cost over $200 million. A VE study and several design alterations cost just $85,000 and shaved $30 million off the project's price tag. The return on investment (ROI): 350 to 1.
- Four studies of Interstate Route 476 near Philadelphia yielded a savings of $25 million. Study costs were $85,000 implementation and redesign cost were $120,000, producing an ROI of 125 to 1.
- A VE study costing less than $20,000 was done on schematic plans for a freeway interchange project in Albuquerque, N.M. At the schematic stage, redesign costs were minimal. Roughly $12 million was saved, creating an ROI of nearly 600 to 1.
- A recent study of the $1 billion South Bay Interchange in Boston identified potential savings of $300 million [illegible]

CIVIL ENGINEERING/JULY 1991

10% of these recommendations are accepted, the study will still yield substantial ROI.

• Currently, a VE study is being performed on a state highway's book of specifications. The original book had some 600 pages of text with 380 pages of specification revisions. The value-engineered final document should be pared down to 470 pages. Savings in publication and distribution is estimated at $250,000, and improved bids, fewer change orders and better specifications could save another $750,000 per year.

Oddly enough, many people familiar with VE have said it doesn't fit the highway industry. They claim highways are too simple: there are too few pieces to the puzzle and too few disciplines involved.

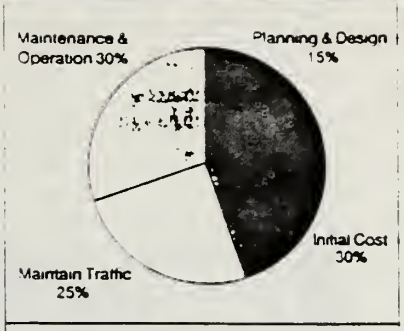
This may have been true 50 years ago, but the advent of the Interstate system, the noise wall, the environmental impact statement, billion-dollar megaprojects and the 2 trillion annual vehicle-miles traveled in the U.S. has created a sophisticated and expensive area of public concern and involvement. Such a complex planning, development and operation effort, coupled with the fragmentation of authority, has diluted the decision maker's authority to control costs. The fact that most decision makers are not financially accountable further aggravates the situation.

In short, the conventional approach to transportation project construction has become ineffective. Traditionally, design professionals develop the concept of a facility to conform to the criteria of the owner/user. Plans and specifications are generated by each design discipline involved. These documents usually are a compromise between the designers' standards and beliefs and those of the owner/user. But this approach often results in decisions that are not the most economical for the facility's end function. Total system performance is sacrificed by maximizing subsystem performance.

Instead, each design professional must realize that he has an impact on cost, and optimum costs occur only when each recognizes how his decision influences the total cost.

Value is defined as the fair equivalent in commodities, offered in exchange for money. The group conducting the VE study uses a proven problem-solving methodology that takes nothing for granted. Everything about a project, even its very existence, is attacked and dissected. The only restriction, of course, is that the project or methods cannot be degraded below needed technical and socioeconomic requirements.

FIG. 1. THE BURDEN OF OWNERSHIP



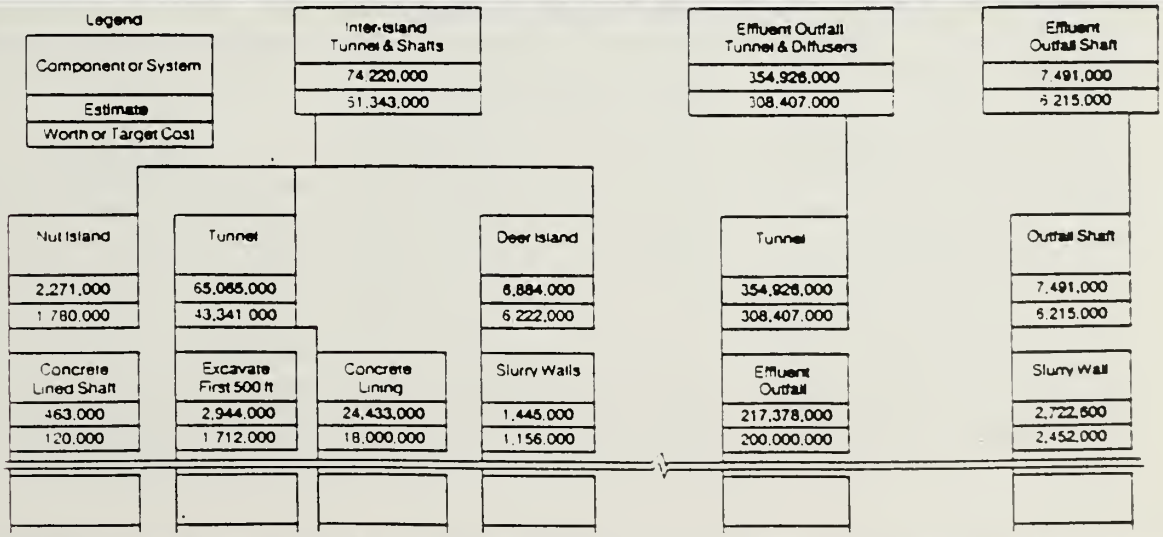
A BREAKDOWN OF LIFE-CYCLE COSTS OVER A 20-YEAR SPAN. NOTE THAT THE INITIAL COSTS ARE LESS THAN ONE-THIRD OF THE TOTAL COST. THE OVEREMPHASIS ON INITIAL COST IS PROBABLY THE GREATEST FLAW IN THE TRADITIONAL APPROACH TO HIGHWAY PROJECTS.

How VE works

VE is based on a number of factors that fly in the face of the conventional way highway projects are conducted. One factor is the total-cost concept. The total cost of a highway project is the money spent to design, construct, operate, maintain and replace a system for a specified period of time (Fig. 1). Surprisingly, the initial costs are less than one-third of the total cost. The emphasis on first or initial cost, without proper regard for the other elements of total cost, is probably the greatest shortcoming of the traditional approach to transportation construction. For instance, traffic maintenance during construction can account for a large share of a project's total cost. Due to increased traffic and environmental conditions, this expense become a more significant element in the cost of ownership.

A second factor is the location and status of the decision makers who have the most influence over the total cost of a project. Typically, the least amount of money spent in the life cycle of a facility is on program management, planning and design.

FIG. 2. BREAKING DOWN THE PROJECT



A COST MODEL WAS USED FOR THE OUTFALL TUNNELS DURING THE BOSTON HARBOR CLEANUP PROJECT. EACH COMPONENT OF THE PROJECT IS ISOLATED AND ASSIGNED A BLOCK, WITH BOTH ITS ESTIMATED AND TARGET COST LISTED.

but the decisions made during the design phase, shaped by user input, have the greatest impact on total costs. Therefore, the highest return on investment can be expected when resources are allocated for value studies early in the design, focusing on the designer and user inputs.

The VE team relies on a formal job plan and a technique called the functional approach, which sets value methodology apart from all other cost-reduction and prevention programs. By defining and evaluating the function of the principal parts of a design or item, the cost-to-value ratio can easily be examined and evaluated. Alternatives are then developed that should result in an optimum facility design.

The job plan is modeled after the scientific approach to problem solving. It's comprised of four components that force people to think in a planned, organized fashion:

- Information is structured to force the problem solver to define the problem in terms of function and isolate specific areas of high cost to worth. This is to ensure that the solutions solve the real problem.

Project elements are defined in functional terms and are segregated on the basis of gross cost vs. worth. This allows the VE practitioner to focus on value improvement. In essence, this converts the problem-solving effort from a scattershot, cost-reduction exercise to a systematic plan for value improvement, in which the problem is first identified.

- Speculation brings out the creative impulses of problem solving. By brainstorming and listing alternate ideas, decision making is improved.
- Analysis focuses on the technical feasibility of the alternatives, various life-cycle costs, and other economic and noneconomic factors.
- Proposals are submitted by the VE team, which the decision makers review and decide whether to implement.

Value Engineering in Action

The scope and direction of value engineering will vary according to the type of project and desires of the users. However, special techniques have been developed to assist in the application.

One technique is the cost model—a tool that breaks down total facility costs into functional units that can be analyzed quickly. The cost model was used during the Boston Harbor cleanup project for the Deer Island outfall tunnels. The different components of the project were isolated and assigned blocks in a flowchart, with both their estimated and target costs (Fig. 2). For instance, the tunnel and shafts were projected to cost $74.2 million, but were given a VE target cost of $51.34 million. All the items and tasks required to build the tunnel and shafts (including excavation, concrete lining, slurry walls and pressure grouting) were assigned blocks, which listed both their estimated and target values.

Typically, the highest return on investment with VE studies is on projects in the range of $100 million and higher.

The target costs represent the minimum cost believed possible for each block of the cost model. They're based on expertise, experience, previous VE studies, the cost of similar facilities and the functional analysis of each block.

Typically, the highest return on investment with VE studies is on projects in the range of $100 million and higher. On smaller projects, though, the ROI can still reach 20–50 to 1.

It's crucial to understand that value engineering is not an effort to cheapen design. Nor is it an attempt to trade off essential functions to cut costs. The primary purpose is to eliminate the costs related to nonessential functions and to minimize the costs for providing the essentials.

The timing of the value studies is crucial; the importance of early concept/development/design studies cannot be overemphasized. When value engineering was first applied to the construction field in the 1960s, studies were limited to the late phases of project development. The results were acceptable, but the potential savings lost due to time factors were even more significant. The carryover of value methodology from its industrial birthplace was not yet comprehensive enough to tackle the full spectrum of project development for major construction jobs.

But case studies from across the U.S. have now shown that the sooner VE is performed, the more effective the results. The concept stage is the best time for a VE study. At this stage, major elements have been made and functional needs and state-of-the-art alternatives can be accurately assessed. Budgets can be developed on a functional basis and design-to-cost efforts can follow. Project scheduling as well as program scheduling will also be enhanced. Tangible savings, however, are difficult to ascertain.

For that reason, the time favored by most government agencies for a VE analysis is at 35% design completion, where clear-cut, tangible savings can be identified. VE analysis at this stage provides plenty of opportunity for new design and implementation without major expenditure of time and money. Major redesign proposals, though, are not appropriate.

When design is 90–100% complete, VE is useful and cost-effective, but hampered by a lack of time to effect changes. Such a VE study is often called a constructability review. It provides a forum to recommend easy design changes and ensures that nonfunctional elements have not crept into the design. At this late stage, VE promotes competition among prospective bidders and highlights cumbersome specifications and outmoded standards.

For optimum results, VE should be done at each of the above stages when project costs are expected to exceed $100 million. For projects from $2 million to $10 million, VE should be performed at 35% design completion. If further cost problems become evident, a follow-up study can be scheduled at the 65% completion phase.

Perhaps most importantly, to be effective, a VE program cannot be a haphazard exercise, subject to the whims and feelings of individual managers. It should be an established element of the highway development process and should receive a consistent amount of funding. A funding level of 0.01–0.03% of the highway budget should be accorded to cost management through the VE process. At this level, a medium-sized state with a modest $200 million annual budget might spend some $300,000 to train VE teams, conduct studies, audit and publicize results, and administer the program. Judging from the return on investment enjoyed in past projects, it would be money well spent.

Alphonse Dell'Isola is vice president in the Value Management Division of SH&E, Washington, D.C. E.D. Johnson of SH&E also contributed to this article.

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

- [ ] Revenue Generating Potential
- [ ] Better Management of Current Resources
- [x] Better Contracting Practice
- [ ] Privatization Potential

Design/Build

PROJECT DESCRIPTION

Contract for delivery of facilities by D/B Contracting. It can be applied to all horizontal and vertical constructions.

COST SAVINGS/GENERATING

The savings is in getting projects built faster. If the process of project delivery can be shortened, the savings to the MDPW is in the cost of money and the benefits to the motoring public are expedited.

ACTION REQUIRED BY COMMONWEALTH

Legislation is probably required. DCPO needed legislation to implement their program. Transportation agencies in other locations have used the concept.

ADDITIONAL PROJECT DETAILS

- Traditional method is to design a project - then hire a contractor.
- In D/B, a design/construct team is selected. Design/construct activities could take place in parallel thus shortening project time frame.

SCHEDULE

- Hire a team to identify legal issues. MIT is doing research on this issue. They could be hired and have a report within 6 months.
- Obtain legislation within a year.

IMPLEMENTATION RESPONSIBILITY

- MDPW commissioner

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

Bridge Maintenance

- [ ] Revenue Generating Potential
- [ ] Better Management of Current Resources
- [x] Better Contracting Practice
- [x] Privatization Potential

PROJECT DESCRIPTION

Inspection, rating, repair (incl. painting) of bridges. This could be done as a design/build contract.

COST SAVINGS/GENERATING

According to DHE, it could save $5 to 10 million.

ACTION REQUIRED BY COMMONWEALTH

Legislation may be required.

ADDITIONAL PROJECT DETAILS

Payment/Selection of Contract team is a critical issue. Monitoring is the other critical element.

SCHEDULE

- Initial think through to identify and resolve all issues relating to contracting - 6 months.
- Develop program, i.e., by District, Region, etc. - 6 months.
- Let out first contracts - 6 months.

IMPLEMENTATION RESPONSIBILITY

Commissioner of MDPW
Chief Engineer of MDPW

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

Review EIR Reports

CLASSIFICATION OF PROJECT

- [ ] Revenue Generating Potential
- [ ] Better Management of Current Resources
- [ ] Better Contracting Practice
- [x] Privatization Potential

PROJECT DESCRIPTION

Reviews of Env. Impact Reports. Hire consultant to do reviews on as needed basis.

COST SAVINGS/GENERATING

Savings are in expediting the process.

ACTION REQUIRED BY COMMONWEALTH

No legal.

ADDITIONAL PROJECT DETAILS

The MDPW now has open-ended contracts to provide EIR services on as needed basis. The Review of EIRs could be done similarly.

SCHEDULE

Select a consultant/consultants within 6 months.

IMPLEMENTATION RESPONSIBILITY

MDPW Chief Engineer

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

1) THE DPW IS CURRENTLY OVER-PRIVATIZED FOR ALL BASIC MAINTENANCE SERVICES. This means that basic maintenance-snow plowing, mechanical repair, sweeping, mowing, catch-basin repair and cleaning, tree work, pothole patching, bridge and deck repair-is now contracted out to such a great degree that the DPW has seen a marked increase in costs, lack of consistency in quality of the work, and a tendency towards monopolization by contractors which again pushes up costs.

2) BASIC MAINTENANCE COULD BE DONE MORE COST EFFECTIVELY AND EFFICIENTLY BY A PROPERLY MANNED DPW. The goal of the DPW should be to maintain the current highway infrastructure of the Commonwealth with in-house forces.

3) TO IMPLEMENT THIS WE ARE RECOMMENDING ESTABLISHING A ASSOCIATE COMMISSIONER OF EFFICIENCY TO:

a) Oversee training of current workforce to improve skills and productivity

b) Better centralize and review equipment repair

c) Provide flexibility in service delivery not allowable in contracted out services

d) Set up a Labor/Management committee to improve quality of services provided; an extension of work done at the Wellesley shop

e) Look at ways to reduce costs and increase productivity

Submitted by Celia Wcislo

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

A public/private partnership format should be developed for local governments to bid on state highway maintenance services. Local governments could use their employees and equipment to provide maintenance services within their town. The state could reimburse the town with Cherry Sheet revenues or priorities on town desired projects.

COST SAVINGS

Actual dollar savings are difficult to calculate. Savings would be realized in contract administration. MDPW management and equipment.

ACTION REQUIRED

This may require a change in procedures, however, intergovernmental agreements could be revised to accommodate public responsibilities.

ADDITIONAL DETAILS

This type of arrangement could result in elimination of duplicated effort by local and state agencies. Local governments could be more responsible for state highways in their community which should result in better service to the taxpayer.

SCHEDULE

Develop outline agreement in six months.

IMPLEMENTATION RESPONSIBILITY

MDPW Commissioner.

J. D. Cleggett
November 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEES

PROJECT DESCRIPTION

Provide private services areas at existing Park & Ride lots. Lease MDPW property to private contractors to service vehicles. In exchange the private contractor would maintain the lot and provide security.

COST SAVINGS

Rental revenue for the Department

ACTION REQUIRED

Develop project requirements and notify Asset Management Board for rental agreement.

ADDITIONAL DETAILS

This arrangement could result in additional revenue when parking fees are required at these Park & Ride lots.

SCHEDULE

Develop project details in six months.

IMPLEMENTATION RESPONSIBILITY

MDPW Commissioner.

J. D. Cleggett
November 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

PREQUALIFICATION CERTIFICATION

- [ ] Revenue Generating Potential
- [x] Better Management of Current Resources
- [x] Better Contracting Practice
- [x] Privatization Potential

PROJECT DESCRIPTION

Centralize prequalification certification from several State Agencies into one (1) department.

Most information submitted for contractor prequalification is the same for all State Agencies.

COST SAVINGS/GENERATING

Dollar value unknown. Time saved in addition to redundancy of efforts would be of a large magnitude.

ACTION REQUIRED BY COMMONWEALTH

State Agencies combine efforts eliminating duplicity or privatize this effort with an outside firm.

ADDITIONAL PROJECT DETAILS

Not only would monies be saved, but the turnaround in prequalifying contractors could be more efficient.

SCHEDULE

Should be in full operation within six months to a year.

IMPLEMENTATION RESPONSIBILITY

MDPW
MBTA
MDC
DCPO

Project Submitted by Robert L. Mabardy

Date: November 21, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

- Investigate leasing of vehicles and commonly used trucks

COST SAVINGS

- Should be studied but may be substantial. Under Asset Management Board, up to 50% of assets enure to MDPW.

ACTION REQUIRED BY COMMONWEALTH

- Unknown

IMPLEMENTATION RESPONSIBILITY

- MDPW

Project Submitted by Fay Fialkow

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

Equipment Leasing with Maintenance

PROJECT DESCRIPTION

Advertise an intent to lease vehicles of various and descriptions as needed to provide the necessary services and let the market place respond with options they can provide.

COST SAVINGS

This can only be determined by the response to the notice of intent and a comparison to present costs. Savings can be attained not only in equipment directly but also in manpower saved through reduction of down-time for personnel awaiting vehicle repair.

ACTION REQUIRED BY COMMONWEALTH

Permission or legislation will be required to participate in long term lease arrangements which is required to make the option viable.

ADDITIONAL PROJECT DETAILS

None.

SCHEDULE

Approximately one year will be required to advertise, analyze, evaluate, prepare a contract and implement.

IMPLEMENTATION RESPONSIBILITY

MDPW, EOTC, A&F, Legislature (?)

Project Submitted by John F. Hurley

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

Reorganize and supplement MDPW work forces to be effectively responsive to their existing mandates.

COST SAVINGS

With a staff that can be responsive to demands abetter utilization of existing resources can be attained.

ACTION REQUIRED

Filling crucial vacant positions.

ADDITIONAL DETAILS

None.

SCHEDULE

Should be fully implemented during fiscal year 1993.

IMPLEMENTATION RESPONSIBILITY

MDPW, EOTC, Legislature

Project Submitted by John F. Hurley

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

Rest area commercialization/park and ride facilities.

COST SAVINGS

Monies would be generated through the rental of facilities and parking arrangements would be a stipulation of the lease, to be provided by the lessee as directed by the MDPW.

ACTION REQUIRED BY THE COMMONWEALTH

Implementation by MDPW as is now being done with a few areas.

ADDITIONAL PROJECT DETAILS

Will require coordination with and approval of the Federal Highway Administration.

SCHEDULE

Advertise availability and let the marketplace express their interests in uses and time for implementation. The time required to advertise, evaluate and implement by the MDPW would be at least six months after receiving proposals.

IMPLEMENTATION RESPONSIBILITY

MDPW

Project Submitted by John F. Hurley

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

- Lease maintenance building and land at the intersection of Route 128 and Route 9

COST SAVINGS

- It is hard to estimate but prospective tenants for retail may pay as much as $1 Million per year for such a location. Under Asset Management Board, up to 50% can enure to MDPW.

ACTION REQUIRED BY COMMONWEALTH

- This can be handled through the Department with the approval of the Asset Management Board

SCHEDULE

- This can be accomplished with an initial appraisal, open to bid and approval by Asset Management Board within one year

IMPLEMENTATION RESPONSIBILITY

- MDPW Manager

Submitted by:
Jay Fialkow

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

- [ ] Revenue Generating Potential
- [x] Better Management of Current Resources
- [x] Better Contracting Practice
- [ ] Privatization Potential

Contracting Practices

PROJECT DESCRIPTION

The question is whether the process of hiring a contractor/consultant and the processing of change orders can be streamlined.

COST SAVINGS/GENERATING

The savings could be enormous. Not only in dollar outlay to the contractors but also in the amount of time needed by MDPW personnel.

ACTION REQUIRED BY COMMONWEALTH

- Legislation may be required.
- Bulletins issued by Secretary of Administration and Finance need to be reviewed for applicability to unique conditions of maintenance and budget cycle, and construction of capital facilities.

ADDITIONAL PROJECT DETAILS

The system is rather pedantic. The result is that it takes a longer period to process paperwork. Time means money. Similarly, the public needs to be protected.

SCHEDULE

- A task force established with outside help to review the whole process. Gather data from similar agencies in other states. The whole process should be done within 6 months.

IMPLEMENTATION RESPONSIBILITY

- Commissioner of MDPW

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

CLASSIFICATION OF PROJECT

- [x] Revenue Generating Potential
- [ ] Better Management of Current Resources
- [ ] Better Contracting Practice
- [x] Privatization Potential

Real Estate Management

PROJECT DESCRIPTION

Market real estate holdings of the MDPW in order to:
- Generate Revenue
- Provide parking facilities for motoring public

COST SAVINGS/GENERATING

Difficult to estimate how much money could be generated. However, by hiring firms on a contingency basis and taking advantage of Asset Management Board, the MDPW could gain income with little out-of-pocket investment.

ACTION REQUIRED BY COMMONWEALTH

No special legislation required. I believe the MDPW already has the authority to dispose of land not needed for highway purpose.

ADDITIONAL PROJECT DETAILS

Retain a marketing firm on a contingency basis. Identify land along highways that could be used for development particularly park-and-ride lots or garages. The MDPW could actually obtain all permits. As the largest landowner in state, MDPW needs to take a pro-active stance.

SCHEDULE

- Select a Marketing/Planning firm within 6 to 9 months.
- Goal to have a developer kit out on the street within 18 months.

IMPLEMENTATION RESPONSIBILITY

- MDPW Commissioner

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICE SUBCONTRACT

Study Practices of
MDPW Maintenance

CLASSIFICATION OF PROJECT

- [ ] Revenue Generating Potential
- [x] Better Management of Current Resources
- [ ] Better Contracting Practice
- [x] Privatization Potential

PROJECT DESCRIPTION

Study the maintenance practices of MDPW. Utilize studies previously done. The MDPW needs to utilize the systems now available.

COST SAVINGS/GENERATING

The savings in actual dollars and frustration relief to MDPW employees could be substantial based on previous reports.

ACTION REQUIRED BY COMMONWEALTH

No special legislation is required.

ADDITIONAL PROJECT DETAILS

I would find the states/authorities/quasi public agencies who are doing similar tasks. Utilizing an organization like AASHTO, I would put together a task force to study the practices.

SCHEDULE

- Establish Task Force ASAP.
- Study done within a year.

IMPLEMENTATION RESPONSIBILITY

Commissioner of MDPW

Project Submitted by Domenic E. D'Eramo

Date: October 7, 1991

TRANSPORTATION PRIVATIZATION TASK FORCE
HIGHWAY SERVICES SUBCOMMITTEE

PROJECT DESCRIPTION

- Investigate leasing of vehicles and commonly used trucks

COST SAVINGS

- Should be studied but may be substantial. Under Asset Management Board, up to 50% of assets enure to MDPW.

ACTION REQUIRED BY COMMONWEALTH

- Unknown

IMPLEMENTATION RESPONSIBILITY

- MDPW

Project Submitted by Fay Fialkow

Report of the Aviation Subcommittee on Privatization at THE MASSACHUSETTS PORT AUTHORITY (MASSPORT) AND LOGAN INTERNATIONAL AIRPORT

1.0 SUMMARY RECOMMENDATIONS

Boston's Logan International Airport is owned and operated by the Massachusetts Port Authority, also known as Massport. Massport is an independent public authority created by legislation in 1956; it assumed ownership of Logan Airport in 1959. It also owns Hanscom Field, the Tobin Memorial Bridge, and Boston seaport facilities.

Logan presents both singular benefits and difficult problems. Clearly one of the most important economic engines in the region, its proximity to downtown Boston makes it unusually convenient for business travelers. At the same time, Massport's best intentions notwithstanding, the demands of aircraft, truck, auto, and human traffic at the airport and ancillary facilities make it a troublesome neighbor to its surrounding communities.

In May, 1991, the Aviation Subcommittee of the Transportation Privatization Task Force was created to examine the airport and its operations, to initiate research into the current status of airport privatization in the U.S. and overseas, and to make recommendations as to privatization opportunities that might exist at Logan -- not only at the present time but in the future, as Logan plans its operations into the 21st century.

The Subcommittee focused on privatization opportunities at Logan in two general areas. The first area it calls *structural privatization*, in which the ownership and/or operation of Logan Airport as a whole or in major functional parts, such as so-called "landside" and "airside" operations, is taken over by private interests. The second area it calls *component privatization*, in which specific smaller operating entities within the airport are similarly owned and/or operated by private interests.

Structural privatization has recently been proposed for a number of airports both overseas and in the U.S. (including Logan Airport, in a new study by the Reason Foundation). In a few cases, most notably at a group of major airports in the United Kingdom, such large-scale privatization has been successfully implemented. However, there are at the moment significant legal, financial, and public policy impediments to such a large-scale privatization at a major U.S. airport such as Logan. The Subcommittee feels that Massachusetts policymakers should continue to monitor any changes in the structural context for U.S. airport privatization, and if and when such changes occur then a thorough evaluation of such privatization should be undertaken.

The Subcommittee feels that several opportunities for *component privatization* do presently exist at Massport and Logan Airport, and it recommends that the preliminary work of this Subcommittee be used as the basis for the creation of an ongoing **Advisory Committee on Massport Privatization.** This Advisory Committee, which would include current Subcommittee members as well as other private citizens and representatives from Massport and the Weld Administration, would work with Massport to analyze and implement privatization opportunities in three areas at Logan Airport: **passenger and cargo terminal ownership and/or management, fueling systems, and concessions**. The Subcommittee believes that privatization initiatives in these three areas could have a singularly beneficial effect both on

current operations at Logan and on the upcoming implementation of the Logan Airport Modernization Program.

The Subcommittee has proposed the creation of such an Advisory Committee to the Massport administration, which has given its preliminary agreement.

1.1 Secondary Recommendations

The Subcommittee's mandate and research was focused specifically on privatization at Logan Airport. However, in examining Logan operations it was necessary for the Subcommittee to study a variety of policy issues relating to the airport, including the ongoing debate over the addition of a new commuter runway, and to consider the extent of financial and operational integration of all Massport entities, including Hanscom Field, the seaport, and the Tobin Bridge.

The Subcommittee took note of the current need for substantial Logan revenue subsidization of both the seaport and the Tobin Bridge, and feels that this financial relationship should at a minimum be the subject of public policy review. In particular, since toll revenue from the bridge does not fully support either bridge operations or future reconstruction, as a part of this preliminary analysis the Subcommittee recommends that absent a decision to raise tolls to the necessary levels, Massport should evaluate the privatization or sale of its Tobin Bridge facility.

Massport provided the Subcommittee with a brief overview of its operations at Hanscom Field, along with its analysis of the development of the so-called "T" hangars as a privatization opportunity. The Subcommittee agrees with Massport's analysis and recommends that the Advisory Committee fully consider such private development.

2.0 COMPREHENSIVE RECOMMENDATIONS

2.1 Conceptual Background

Although certain ambiguities exist in its precise application, the word "privatization" is used by the Subcommittee in what has become its popular definition: the transfer of ownership and/or management of public facilities -- jails, schools, roads, buildings, even airports -- to private interests which would operate them for profit, albeit with appropriate regulatory oversight. The reasons for such transfers vary case by case; most often the proximate goal is greater operating efficiency or a differential use of (or access to) capital.

Over the past several years there has been an increasing amount of discussion regarding how and where such privatization might be appropriately applied -- witness the other sections of this Task Force report, as well as other privatization initiatives being undertaken in Massachusetts and elsewhere.

The idea that government, and its governors, should on a regular basis evaluate the structure and efficiency of public institutions is to state the obvious. While it is a first principle that public officials should serve and protect the public interest, it does not then follow that the public interest is best served by government accumulating institutions and assets and preserving them under public management. And of course one should be fully as skeptical of the opposite view, that government necessarily serves best by selling its operations to the private sector.

Certainly both public and private enterprise can suffer, at the very least, from institutional aging. A profile of the National Aeronautics and Space Administration (NASA) in *The New Yorker* (September 2, 1991) suggested that NASA might have "become afflicted with some of the same ailments [such as] an attitude of caution that precludes the taking of any risks...that are found in

many other large, mature institutions, particularly those institutions which have no direct and immediate competition to stimulate change."

Such possibilities can, however, be transformed into statements of conventional wisdom, and the Subcommittee decided early on to be alert to all such shibboleths. Just as it is not the case that public institutions should always be run by public employees, neither will public employees always be less efficient and less productive than their private counterparts. Just as it is not the case that private enterprise will inevitably disregard the public interest and make decisions based on greed and narrow self-interest, neither will public employees always be incorruptible and dedicated to the commonweal.

All this is to say that the complex arguments for and against privatization must be fully realized, and the appropriate analytic construct designed, before the decision-making process is engaged. This is the process that the Subcommittee hopes to encourage with this report.

2.2 General Background: Privatization at Logan Airport

The privatization of public assets or services is not equivalent to hanging a "for sale" sign on the public's welfare, as some whom the Subcommittee interviewed might suggest. Similarly, the contemplation of privatization does not mean that the public agency at issue is inefficient or worse. It could be, for example, that a private *structure* is simply more appropriate for certain purposes.

Even so, the Subcommittee feels that airport privatization -- particularly such large-scale privatization as the sale of the airport itself -- is a serious and complex issue, and that the arguments for such a change must be powerful and persuasive. There must be more substance to

the proposal than simply the opportunity to make a public monopoly private, with all of the attendant concerns for public oversight.

An evaluation of the potential for privatization at Logan must be undertaken in the context of Logan's unique role in the city, state, and region. Clearly one of the most important economic engines in the Northeast, its proximity to the downtown area makes it unusually convenient for Boston passengers and cargo. At the same time, the demands of aircraft, truck, auto, and human traffic at the airport and ancillary facilities make it a troublesome neighbor to its surrounding communities. Unlike some other so-called "hub" airports of its approximate passenger size, Boston is fundamentally an "origin and destination" (O and D) airport; as a result, the passenger-related ground transportation requirements at Logan are proportionately greater.

The Massachusetts Port Authority (also known as Massport) assumed ownership and operation of Logan Airport in 1959. An independent public authority created by legislation in 1956, Massport also owns Hanscom Field, the Tobin Memorial Bridge, and Boston seaport facilities. It should be noted that among people familiar with Logan and comparable airports, the Subcommittee found a generally high regard for Massport's operations, and placed it in the upper rank of agencies of its type.

Massport as a public agency is proud of its longstanding management of a complex enterprise, and confident of its ability to build that enterprise into the next decade and beyond. The Subcommittee also found an agency that was receptive to the idea of constructive change. Albeit without the resources to perform a detailed financial and operational analysis, the Subcommittee made a preliminary examination of the airport's history, current status, and plans for the next decade.

At the same time the Subcommittee also composed a snapshot of the "state of the art" in airport privatization, both in the U.S. and elsewhere. It conducted several interviews with experts in the area, and traveled to London and Toronto to gather data on the best current examples of different types of privatization. The Subcommittee also gathered a large amount of published material, including a report published by the Reason Foundation in November which advocated the sale of Logan Airport to private interests.

The Subcommittee found that, as with many other areas of private investment in the public infrastructure, serious discussion of airport privatization is widespread, and shows no signs of diminishing. The Subcommittee also found that at present airport privatization projects exist on a large scale in a few places, and on a smaller scale in a substantial number of places. In the case of Logan, the Subcommittee found that a substantial amount of the operation of the airport is already in private hands: out of 15,500 jobs at the airport, just over 500 are Massport personnel. Nevertheless, the Subcommittee feels that additional opportunities exist, and concluded that the public interest might be served by the introduction of strong private participation in certain aspects of the Logan operation.

2.3 Structural Privatization

By "large-scale privatization" -- which the Subcommittee calls *structural privatization* -- the Subcommittee means the sale or transfer of management function for the airport either as a whole or in major functional parts, such as so-called "landside" and "airside" operations. ("Airside" is normally defined as all airport operations, and thus all cost and revenue centers, involving runways, taxiways, and parking aprons; "landside" is all other cost and revenue centers, including terminals, passenger services, and parking.) While the Subcommittee found many of the arguments for structural privatization provocative, it felt that certain legal, financial, and policy

considerations combined to create a problematic environment for such a privatization effort at the present time.

The most significant structural privatization project was completed in 1987 in the U.K., and others are being discussed in a number of locations, including Turkey, New Zealand, Greece and Denmark. Although there has been discussion of the structural privatization of several large U.S. airports -- including the New York airports, Los Angeles, Chicago, Philadelphia, and Atlanta -- there have not to date been any successful projects. Among the impediments to project completion in the U.S. has been a disinclination on the part of the Federal Aviation Administration (FAA) to allow structural privatization at airports receiving federal Airport Improvement Program (AIP) funds -- a category which *de facto* includes all the country's major airports.

Recently the FAA rejected a proposed 40 year private lease-management contract (and subsequent modernization plan) for the Albany, New York airport. In discussing the proposal's failure with the Subcommittee, the proposed airport operator characterized the problem as the FAA's restrictive interpretation of the requirements of the Airport and Airways Improvement Act of 1982, specifically the need to keep proceeds from the proposed "sale" (in the form of a large front-end transfer payment to the County government) *on the airport.*

The AIP requirement to keep sale proceeds or profits "on airport" is the most frequently cited in discussions of structural obstacles, even though there are examples of the FAA allowing profit-making private operators to receive AIP funds at publicly-owned airports. For example, the Burbank, California airport is publicly owned but privately managed, as are the airport in Teterboro, New Jersey and the landside operations at Atlantic City, New Jersey. (It should be pointed out that the landsides of public airports characteristically receive substantially smaller AIP funding than airside facilities).

Several experts interviewed by the Subcommittee expressed the opinion that the FAA's attitude toward structural privatization may be changing, and that the general support of the Bush Administration for privatization efforts should affect the privatization environment. In the Albany case, for example, the Department of Justice was supportive of the project, and criticized the FAA decision. Several structural proposals (including the Reason Foundation report on Logan) take a different approach, suggesting that a successful privatization effort might require discontinuing any further AIP support, and even repaying the federal government some or all of AIP funds already received.

Other impediments to structural privatization include the loss of access to tax-exempt capital (a situation that does not exist in the U.K., for example), the imposition of new income and property tax obligations, and the assumption of substantial tort liability by the private operator. Although each consideration should be taken seriously by a would-be buyer or operator, the Subcommittee does not feel that they are, either individually or collectively, insurmountable obstacles. First, the playing field can be changed: there always the possibility of legislative remedy. But even without revision they are essentially financial considerations which one would expect to be part of the calculus of the overall proposal. The public interest is affected only if the financial equation of a private operator requires the imposition of substantially higher user fees -- a negative scenario often suggested by privatization opponents.

Passenger Facility Charges (PFCs) are expected to go into effect at FAA-approved applicant airports during 1992. A typical airport's PFC, which will take the form of a ticket surcharge of as much as $3 per emplaned passenger (or over $30 million at Logan), must be earmarked for a specific airport purpose. While PFCs should provide a useful source of new airport funds (especially since few major airports receive an amount even approaching their proportionate share

of the existing 8% ticket tax) the PFC program as it now stands may be an impediment to structural privatization projects; although there is debate on the subject, the Subcommittee feels that at present only a public airport operator has the standing to apply for PFCs.

The valuation of airport properties for possible sale is also a controversial element of the structural equation. Reacting to a proposal to sell Kennedy and LaGuardia airports for $3.2 billion, the Port Authority of New York and New Jersey argued heatedly that the public "windfall" would be much less: their estimate of the sale value was just over $2 billion. The Subcommittee found this a somewhat unusual and perhaps ironic argument: interestingly, many opponents of privatization warn of the opposite outcome, that public assets will be undervalued and sold on the cheap to bargain-hunters. The Subcommittee feels that while valuation doubtless would be challenging, it should not be a reason to reject structural privatization *a priori*. Instead, the public entity should first affirm its interest in selling, and then calculate its price "floor" just as a potential buyer would calculate its "ceiling". Any structural privatization would clearly have a high profile, and the process should be under continuing review to ensure that fair value is proposed and received.

To look at the New York proposal for a moment longer, many published analyses do indeed concentrate on the capitalization of public assets, and the return of that capital to government or the public through a sale process, as the most powerful central argument for structural privatization. The public's perception of the privatization debate, particularly as it concerns airports, has doubtless been influenced by the media's (understandable) focus in each case on the proposed cash gain from the sale of a public asset. Nevertheless, the Subcommittee finds that argument, when it stands alone without a fully developed analytic model of the other costs and benefits of privatization, to be unpersuasive and poor public policy. The rationale for structural privatization must include other elements, such as powerful operating efficiencies, to overcome the "if it ain't broke, don't fix it" defense put forward by current airport operators.

Advocates of structural privatization most often point to the privatization of the British Airport Authority (BAA) as the most comprehensive and most successful project of its sort. In 1987, London's Heathrow, Gatwick, and Stanstead airports as well as four airports in Scotland were purchased from the British government for $2.2 billion by BAA plc, a new publicly held firm with 800,000 shareholders. The initial public offering which raised capital for BAA was many times oversubscribed, reflecting a number of considerations including the Thatcher government's track record of successful privatization in other areas.

A total of 73 million passengers per year travel through BAA's airports. BAA notes that their airports' revenues and pretax profits (in the most recent fiscal year, approximately $4 billion and $400 million, respectively) have increased every year since 1987, and the airports' market value, employee productivity, passenger satisfaction, and capital spending have similarly increased. BAA makes particular note of the last category, since critics of privatization often suggest that a private company will be slower to engage in necessary capital spending. In fact, BAA is investing heavily in terminal improvements, hotel development, and a fast Heathrow-London rail link.

BAA has also been able to increase commercial and concession revenues significantly. The head of airport planning for British Airways notes in Frequent Flyer Magazine (November, 1991) that BAA is "trying harder to have a good public image...[privatization] has also made them more commercial activities-oriented." (It is worth noting that airlines are usually opposed to structural privatization, assuming that their costs will increase under private airport operation).

A number of proponents of structural privatization cite the advantages a private operator would have in the generation of new revenue streams from the aggressive development of unutilized or underutilized airport property. While this argument clearly enjoys a logical foundation and

successful precedents, the Subcommittee did not find it persuasive as a dominant rationale for privatization. Indeed, BAA, arguably the most successful airport privatization enterprise in the world, by its own admission stumbled badly when it bought a real estate company to develop airport land. The argument also becomes moot when discussing Logan Airport, since at 2,400 acres Logan is one of the smallest major airports in the U.S., approximately one tenth the size of Dallas-Fort Worth, for example.

Perhaps the most controversial element of structural privatization is the preservation of certain elements of public control through the operation of a new or expanded regulatory apparatus. BAA has indeed been the object of criticism on the issue of prices and fees, particularly those charged to U.S. carriers. One report suggests that BAA has raised user fees every year, while at the same time BAA's per-passenger operating costs have declined by more than 50 percent in the five years since privatization.

The Subcommittee discussed these regulatory issues both with BAA officials and with officials from the Civil Aviation Authority (CAA), the agency empowered with regulatory oversight. The CAA is currently engaged in a legislatively-mandated review, and preliminary conclusions suggest that BAA may in the near term be constrained in its pricing policies. Whatever the CAA's conclusions, the Subcommittee feels that an effective control mechanism exists, and that this mechanism strengthens the argument that control of structural privatization can be effected through regulatory oversight. Indeed, the popular assumption that the public will automatically have greater control over a public facility is at least debatable: Los Angeles International Airport recently doubled its parking rates without any meaningful public review.

In summary, the Subcommittee feels that although privatization proposals are being put forward with increasing frequency, and although there are interesting examples of completed projects such

as BAA, there are at the moment significant impediments to such a large-scale privatization at a major U.S. airport such as Logan. The Subcommittee feels that Massachusetts policymakers should continue to monitor any changes in the structural context for U.S. airport privatization, and if and when such changes occur then a thorough evaluation of such privatization should be undertaken.

2.4 Component Privatization

The Subcommittee also studied a number of examples of what it calls *component privatization*, in which specific smaller operating entities within the airport are owned and/or managed by private interests. In its discussions with Massport there was agreement that the three areas of the airport where there was the most substantial opportunity and the most immediate need for privatization were terminal ownership and/or management, fueling systems, and concessions. The Subcommittee believes that privatization initiatives in these three areas could have a singularly beneficial effect both on current operations at Logan and on the upcoming implementation of the Logan Airport Modernization Program (LAMP).

2.4.1 Terminal Ownership and/or Management

There are a number of examples of successful private ownership or management of airport passenger and cargo terminal facilities, including the recent and impressive opening of Terminal 3, called the Trillium Terminal, at Toronto's Lester Pearson International. Trillium was financed and built by a private consortium which included its operator, Lockheed Air Terminal. Interestingly, it was deemed preferable to transfer actual ownership of Trillium back to Transport Canada (the public entity which owns and operates the rest of Pearson) after construction; the private operator now leases the terminal.

Trillium illustrates one of the prominent arguments for private terminal construction: according to Transport Canada, the private Trillium was built in perhaps half the time it would have taken the government. (While the Subcommittee agrees that a public agency does indeed have certain impediments, such as public bidding laws, which tend to extend the construction process, the success of design-build projects -- such as several new jails and prisons in Massachusetts -- should also have application in airport construction).

Trillium also illustrates the new aggressiveness in terminal retail operation which is found at BAA airports: the retail components are designed and built not simply to provide old-style concessions more efficiently, but in fact to significantly increase the size and scope of the marketplace. For example, both Trillium and BAA have in-terminal signature stores from the department store Harrods of London; the Trillium Harrods is the first such branch in North America.

Of the five passenger terminals at Logan Airport (including Terminal D, currently used for charter operations), three terminals are operated by Massport and two terminals are operated by airlines under lease agreements. Terminal A was built for approximately $20 million by Massport in 1969 and leased under triple net terms to Eastern Airlines. Terminal B was built by Massport in 1976 at a cost of approximately $50 million, and leased through 2001 to the South Terminal Corporation, a three-airline consortium of American, U.S.Air, and Northwest (Northwest's interests have since been transferred to Massport).

The Terminal A lease to Eastern, which is in bankruptcy and is no longer operating, runs until 1994. Continental Airlines and the Trump Shuttle are currently tenants on a month-to-month basis. The Terminal has 1000 integral parking spaces and has 14 jet gates, the majority of which were built for narrow-body jets.

Built from an experimental post-tension design, Terminal A needs immediate additional structural support to resist lateral stress, and its narrow-body gate characteristics are outdated. It also needs significant cosmetic repair and updating. The Logan Airport Modernization Plan calls for its replacement, and assumes the construction of a 14-gate terminal at approximately $10 million per gate, or $140 million. A complicating factor is the terminal's proximity to the right-of-way of the Third Harbor Tunnel, which will affect both aircraft movements and new concourse construction.

It would be possible to extend the useful life of the current terminal building with extensive renovation, including changes in hold rooms, gate design, and security, and with the addition of new widebody gates, presumably from a central pier.

The Subcommittee feels that Terminal A represents a privatization opportunity for a non-airline operator to either renovate the existing structure and extend its useful life, or phase out the current terminal and build a replacement. Among the advantages that a private terminal operator might provide are construction expertise and ability to expedite the construction process (as the Subcommittee saw in a visit to the Trillium Terminal in Toronto), improved efficiency in ongoing operation, and access to private capital. The last point is of particular importance given the approximately $1 billion overall cost of LAMP.

2.4.2 Fueling Systems

Logan Airport currently has seven fuel farms on the airport, all controlled by the airlines, of which two are shut down (Eastern and TWA) and two are in the right-of-way of the Third Harbor Tunnel. The tank capacities range from 1.5 days storage to 7 days storage, with an average of 3 days. There is significant leakage from one or more older tanks, and Massport is currently

performing a ground-water study for the Department of Environmental Protection to determine the magnitude of the problem.

Of the two aircraft fueling processes, so-called "hydrant" fueling is much preferred over the alternative of truck fueling, for reasons of speed and safety. Even though Logan is entirely hydrant-capable (except for a few cargo positions), the multiple fuel farm systems frequently produce mismatches (i.e., an airline's gate position is fed by another airline's hydrant) and require truck fueling of aircraft. Most airports have pipeline delivery to their on-airport fuel farms; except for one small pipeline run from Mobil in East Boston the Logan farms are inefficiently fed by tank truck delivery from the Chelsea Creek area or Everett.

There is a need for a centralized fuel storage system at Logan which can feed all terminal hydrants, a project Massport has estimated would cost $50-70 million and take 2-3 years to build. Among the issues such a project would need to address include the area taken for central storage, as well as the total storage capacity (the airlines, not surprisingly, are advocates of 7 days storage, which would allow them to arbitrage fuel prices), and control and management.

Massport itself does not have the expertise to design and build such a system, or to manage it in operation. The Subcommittee feels that a private company with experience in fueling systems might well provide the most efficient and cost-effective way to solve the fueling problem. Because of the enormous fuel throughput of such a system, the operating cash flow would undoubtedly be strong enough to support an attractive financing package.

Massport has recently received a consultant's report, commissioned by a consortium of Logan airlines, on the construction of a new Logan fueling system. The Subcommittee recommends that

the Advisory Committee include a review of this report in its ongoing study of Logan privatization opportunities.

2.4.3 Terminal Concessions

Airport terminal concessions -- food and beverages, news and gifts, duty free shops, vending machines, and other miscellaneous services -- are often the most frequently criticized part of the passenger's air travel experience. Flyers find them overpriced and underserved, poorly designed and badly maintained.

As with private terminal development, there are a number of examples of new private approaches to concessions. Perhaps the most interesting is illustrated at Pittsburgh's soon-to-open Midfield Terminal, where after an open competition BAA (in its first U.S. operation) was given a fifteen year contract to act as the overall concession manager. The introduction of what amounts to a middleman -- a hired concession manager which then selects and manages the actual concession vendors -- might seem counterintuitive, but proponents argue that the cost of the middleman is more than made up by operating expertise and the resulting efficiencies.

This new master-concession approach is being considered at a number of airports, including Washington National. As is noted in Section 2.4.1, there are several impressive recent examples (such as Lockheed's Trillium in Toronto and the BAA airports) of "new thinking" in the terminal retail marketplace, including aggressive mini-malls and department-store operations. The strategic concept is both to attract a greater number of retail customers and to increase the per-customer concession revenue. (Indeed, BAA enjoys a per-passenger average revenue three to four times that of Logan).

Logan Airport has a potpourri of concession relationships. In Terminals A and B the terminal management has engaged an operator (in both cases Marriott/Host) with a master lease for all concessions. In Terminals C, D and E concessions are atomized; Massport has different contracts for each service at each terminal. The total Logan concession revenues are approximately $1 per emplaned passenger, or $12 million.

Several major airports are now engaging an overall concession operator for airport-wide management, and there is evidence that identifying an operator which is not itself a concessionaire but which is a professional retail manager inserted between the actual service providers and the airport operator serves both to increase revenues and improve service. Professional retail management would know how to use space better, how to react faster, and would do better market research and evaluation. The Subcommittee feels that Massport's net revenue from concessions might well be increased by expanding concession opportunities and examining the potential of a concession master lease.

2.5 The Advisory Committee on Massport Privatization

As described above, the Subcommittee feels that several opportunities for privatization, specifically in the area of *component privatization*, do presently exist at Massport and Logan Airport, and it recommends that the preliminary work of this Subcommittee be used as the basis for the creation of an ongoing **Advisory Committee on Massport Privatization.** This Advisory Committee, which would include current Subcommittee members as well as other private citizens and representatives from Massport and the Weld Administration, would work with Massport to analyze and implement privatization opportunities at Logan Airport. The Subcommittee believes that privatization initiatives in these three areas could have a singularly beneficial effect both on current operations at Logan and on the upcoming implementation of the

Logan Airport Modernization Program. The Advisory Committee would bring to Massport new expertise on the leading examples of, and principal failures of, privatization, and would make input available to Massport from private interests as well as the Weld administration.

The Subcommittee has proposed the creation of such an Advisory Committee to Massport, and the Massport administration has given the Subcommittee its preliminary agreement.

2.6 Secondary Recommendations

The Subcommittee's mandate and research was focused specifically on privatization at Logan Airport. However, in examining Logan operations it was necessary for the Subcommittee to study a variety of policy issues relating to the airport, including the ongoing debate over the addition of a new commuter runway, and to consider the extent of financial and operational integration of all Massport entities, including the Tobin Bridge, the seaport, and Hanscom Field.

When Massport assumed ownership of Logan Airport in 1959, the Tobin Bridge (already under Massport) generated an excess of revenues, which were then directed to airport development. This cross-subsidization was a clearly understood and designated executive and legislative intention. By 1991 the equation had changed significantly, and excess airport revenues (which are allowed to go "off-airport" by a special federal dispensation) are now used to support operations at the Massport seaport facilities and the Tobin Bridge.

The Subcommittee does not have either the resources or the mandate to make a thorough analysis of this new cross-subsidization structure. However, it does feel that at the very least the policy implications of this new relationship should be examined, particularly since over 30 years have elapsed since the original subsidization program was legislated. It may be, for example, that

being forced to support the losses of the Tobin Bridge through airport revenues is not in Massport's best interests, or in the overall interests of the citizens of the Commonwealth.
In the specific context of privatization, the Subcommittee feels that the attention being paid to privatization of toll roads and bridges elsewhere may create an opportunity for Massport; in particular, since toll revenue from the bridge does not fully support either bridge operations or future reconstruction, as a part of this preliminary analysis the Subcommittee recommends that absent a decision to raise tolls to the necessary levels, Massport should evaluate the privatization or sale of its Tobin Bridge facility.

Massport provided the Subcommittee with a brief overview of its operations at Hanscom Field, along with its analysis of the development of approximately 100 "T" hangars (so called because of the door opening in the shape of an inverted T) as a privatization opportunity. (The Subcommittee agrees with Massport's analysis and recommends that the Advisory Committee fully consider such private development.)

A substantial amount of the Massport-owned maritime property has been leased to private interests, such as the World Trade Center, Constitution Wharf, and the Fish Pier. Massport does operate, at a loss, the Boston seaport cargo terminals. As is noted above in the context of the Tobin Bridge, the Subcommittee had neither the mandate nor the expertise to analyze the operation of the Massport terminals; nevertheless, the Subcommittee took note of the ongoing subsidization of the seaport facilities from airport revenues, and feels that Massport, and the Commonwealth, may wish to reevaluate the nature and level of this cross-subsidization as part of a larger policy review.

LEGISLATION

for the

Asset Management Board

CHAPTER 7B.

ASSET MANAGEMENT BOARD.

Section 1. As used in this chapter, the following words shall, unless the context clearly indicates otherwise, have the following meanings:-

(a) "Asset" all property that is in the lawful possession of or otherwise held by a state agency, and shall include without limitation both real and personal property and property interests regardless of whether they are held in tangible or intangible form. Without limiting the generality of the foregoing, the word "asset" shall include land, buildings, structures, leases, easements, licenses, electronic and communication equipment, and time sharing capacities, air, water, and mineral rights, utilities, vehicles, and professional and technical services and expertise.

(b) "Asset management board" or "board", the asset management board established pursuant to section two.

(c) "Asset management project" or "project" any project for the management or assets that is proposed for the consideration of the board by a state agency and approved by the asset management board pursuant to the provisions of this chapter; provided, however, that this term shall not include any project involving the sale or permanent disposition of any asset.

(d) "State agency" or "agency", any executive office, department, agency, board, or commission of the commonwealth.

Section 2. (a) There is hereby established an asset management board. The board shall be within but not subject to the control of the executive office of administration and finance. The board shall consist of the secretary of administration and finance or his designee, ex officio, who shall serve as chair; the inspector general or his designee, ex officio; and three additional public members appointed by the governor. Of the public members initially so appointed, one shall be appointed for a term of one year, one shall be appointed for a term of two years and one shall be appointed for a term of three years. Public members shall be appointed for terms of three years, without reappointment. At least one public member shall possess substantial expertise in the field of real estate management and development, and at least one public member shall possess substantial experience in the field of finance.

(b) Public members of the board shall serve without compensation. Public members of the board shall be reimbursed for all necessary expenses incurred in the discharge of their official duties. The board's activities shall be supported by staff of the secretary of administration and finance.

(c) No member of the asset management board shall participate in the approval of a project if the member or any member of his immediate family has a direct or indirect present or future financial interest in the approval of the project or in any way will benefit financially therefrom.

(Note: There is no Section 3)

Section 4. The asset management board shall have the following powers and duties:

(a) The board shall promulgate rules and regulations to implement the provisions of this chapter. Said regulations shall include but not be limited to:

(i) establishing standards and procedures to govern state agency presentation to and board review and approval of asset management projects. Such standards shall include, but not be limited to, the promotion of sound management of all assets held by state agencies; the protection against projects with conflicts of interest; the prevention of unfair or windfall profits accruing to any individual or group of individuals; the assurance that approved projects do not interfere with nor deny an agency's access to assets that are needed to meet current or reasonably foreseeable legal obligations of the agency presenting the project; and, assurance that each project is technically and financially viable;

(ii) establishing alternative property procurement and disposition standards and procedures consistent with the authority and requirements set forth in subsection (b); provided, however, that such standards and procedures shall include, but not be limited to, adequate public notice, public review and comment for each proposed asset management project;

(iii) establishing standards and procedures for the monitoring and termination of approved projects consistent with the authority and requirements set forth in subsection (c); and

(iv) ensuring that the agency proposing the project has the capacity to execute the project.

Section 4 (continued)

(b) Notwithstanding any general or special law to the contrary, the board shall be authorized to determine that property procurement and disposition laws and regulations otherwise applicable to projects managed or proposed by state agencies shall not apply to a proposed project. The board shall make such determination only after making a written finding that such project is financially feasible, will not interfere with the mission and functions of the managing or proposing agency, and is in the best interests of the commonwealth. Such written finding of the board shall be available to the public. The board shall establish for each such project alternative property procurement or disposition requirements consistent with standards set forth in its regulations; provided that the board shall not have the authority to limit or modify in any way the application of any property procurement or disposition law or regulation that by its terms applies equally to both public and private agencies or entities.

(c) The board shall monitor approved projects in accordance with standards and procedures set forth in its regulations. Said standards and procedures shall include, but not be limited to, provisions for periodic site visits, submission of an annual independent audit, if applicable, for each project, and review of the public purposes served by the project. The board shall terminate any previously approved project in the event that it determines, in accordance with its standards and procedures, that such project no longer serves a public purpose or is no longer in the public interest.

(d) The board shall have the authority to authorize the establishment of asset management trusts in accordance with the provisions of section eight.

Section 5. Prior to the submission of any project to the asset management board, the state agency making such submission shall first develop an inventory of its assets and identify those assets that are underutilized or might otherwise qualify for management as part of an asset management project pursuant to the provisions of this chapter. If such proposed project is limited to one or more institutions or facilities, such inventory likewise may be limited to the assets contained at such institution or facility. Notice of the submission of a proposed project which involves interests in real property shall be sent to the division of capital planning and operations together with a copy of the inventory. Each such agency proposal shall be submitted to the asset management board only after approval of the executive office within which such agency is located, or, in the case of institutions of higher education, the board of regents.

Section 6. Each proposed project may be developed and managed with the assistance of individuals with expertise in the management of assets similar to the assets included in the proposed project; provided, that the board shall examine the proposed relationship between such individual and the state agency to ensure compliance with the standards of paragraph (i) of subsection (a) of section four. The cost of such assistance may be paid from funds available to the agency for such purpose or from funds held in trust pursuant to the provisions of section eight.

Section 7. Notwithstanding the provisions of section forty E of chapter seven to the contrary, real property, title to which was held in the name of a state agency, or the board of trustees of a facility of a state agency prior to the enactment of said section shall, for the sole purposes of this chapter be considered real property in the lawful possession of the state agency from which such land was transferred to the commonwealth pursuant to the provisions of said section.

Section 8. Notwithstanding the provisions of section four F of chapter seven or any other provision of the General Laws to the contrary, at the request of a state agency, the state treasurer is hereby authorized and directed to establish one or more asset management project trust funds for each state agency with approved asset management projects. Such trust or trusts shall be established to receive fifty percent of the proceeds accruing to an agency as a result of revenues produced by one or more approved asset management projects. The remainder of the proceeds shall be deposited in the General Fund. The administrator in charge of each such state agency shall serve as sole trustee of said trust or trusts, and shall administer the trust so as to advance the purposes served by the agency. No expenditures from said trusts shall be made without the authorization from the secretary of the executive office of administration and finance. All expenditures from said trust funds shall conform to standard state accounting procedures and to such further requirements as prescribed by the comptroller. Each such agency shall report annually to the house and senate committees on ways and means the amount of funds received in and expenditures made from any trust established pursuant to the provisions of this chapter.

* Notwithstanding the provisions of section eight of chapter seven B of the General Laws, for the period beginning with the effective date of this section and ending June thirtieth, nineteen hundred and ninety-two, any asset management trust may be established to receive not more than fifty percent of the proceeds accruing to an agency as a result of revenues produced by one or more approved asset management projects.

*Included in Section 10 of Chapter 5 of the Acts of 1991

Section 9. The provisions of this chapter are not intended and shall not be construed to limit, override or otherwise modify the procedures, powers and duties of the division of capital planning and operations unless specifically so authorized by the asset management board pursuant to the standards and procedures established by this chapter.

— end —

3.0 MEETING AND VOTING PROCEDURES

3.1 Meetings of the Board shall be called at the request of the Chairman or of a majority of the members of the Board.

3.2 Meetings shall be held in the office of the Chairman, unless otherwise noted.

3.3 Proposals to be reviewed at a meeting, including public comments, shall be made available to Board members 7 days prior to the meeting.

3.4 A quorum shall consist of no less than three members present.

3.5 A vote shall require the presence of a quorum and the vote of a simple majority of the members present.

3.6 Votes on a project shall take the general form of one of the following actions: 1) approve the Project, and if applicable, approve establishment of alternative procurement and disposition procedures, 2) disapprove the Project, or 3) request that Agencies submit modified proposals, re-advertise proposals, and/or provide additional information.

3.7 A vote to approve the establishment of alternative procedures must be preceded by a written finding of the Board that the project is financially feasible, does not interfere with the mission and functions of the proposing Agency, and is in the best interests of the Commonwealth. All such written findings shall be made available to the public upon request to the Board in care of the Office of Real Estate Management, DCPO, 1 Ashburton Place, 15th Floor, Boston, MA 02108.

4.0 PUBLIC NOTICE REQUIREMENTS

4.1 Agencies shall, prior to submitting proposals to the Board, publish a Notice of Intent to Submit a Proposal. Such Notice shall include: 1) a brief summary of the Project, including the general location of any real property involved in the Project; 2) location or office at which draft proposals are available; 3) invitation for public comment; and 4) procedures and deadlines for submitting comments. Notices shall also be sent, in the case of a Project involving real property, to the members of the General Court in the Project district, as well as to the city manager in the case of a city under Plan E form of government, the mayor and city council in the case of all other cities, and the chairman of the board of selectmen in the case of a town.

4.2 Notices shall be advertised for two consecutive weeks in the Central Register and at least one newspaper of general circulation covering the Project area. The last Notice shall appear no less than 14 days prior to the consideration of the proposal by the Board.

4.3 Public records of the Board shall be kept at the Office of Real Estate Management, DCPO and may be inspected during normal business hours.

REGULATIONS

for the

812 CMR Asset Management Board

DRAFT
4/24/91

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ASSET MANAGEMENT BOARD
REGULATIONS

(To Be Re-Numbered per CMR)

1.0 DEFINITIONS

1.1 "Agency": any executive office, department, agency, board, or commission of the Commonwealth, including institutions under the Board of Regents of Higher Education, and not including independent authorities.

1.2 "Asset": any property that is in the lawful possession of or otherwise held by a state agency, including without limitation both real and personal property and property interests regardless of whether they are held in tangible or intangible form. The word "asset" shall include, but shall not be limited to, land, buildings, structures, leases, easements, licenses, electronic and communication equipment, time sharing capacities, air, water, or mineral rights, utilities, vehicles, and professional and technical services and expertise.

1.3 "Asset Management Board" or "Board": the asset management board established pursuant to Section 220 of Chapter 150 of the Acts of 1990, which established Chapter 7B of the General Laws, and as may be amended from time to time.

1.4 "Asset Management Project"or "Project": any project to permit more productive use of an asset under the control of an Agency, proposed for the consideration of the Board by a controlling Agency, and approved by the Board. Such projects may be proposed in order to gain benefit from state-owned assets, or to achieve fuller realization of the value of an asset consistent with its continued use by the agency, or for other purposes of benefit to the Commonwealth.

1.5 "Chairman": the Secretary of Administration and Finance.

2.0 POWERS OF THE BOARD

2.1 The Board shall promote the identification of underutilized state-owned Assets, presentation of proposals, and creative reuse of those Assets.

2.2 The Board is authorized to determine that procurement and disposition laws and regulations otherwise applicable to Projects shall not apply to a specific Project, provided that the Board shall not have the authority to limit or modify in any way the application of any law or regulation that by its terms applies equally to both public and private agencies or entities. If a determination is made that procurement and disposition laws do not apply, the Board shall approve alternative procurement and disposition standards and procedures.

2.3 The Board shall execute its authority in accordance with the regulations herein.

5.0 PROPOSAL SUBMISSION REQUIREMENTS

5.1 Proposals by the proposing Agency shall include sufficient information for the Board to make an informed judgment that the proposed Project:

5.11 represents sound management of assets held by the agency;

5.12 is technically and financially viable;

5.13 does not interfere with current or foreseeable legal obligations of the Agency;

5.14 does not constitute a conflict of interest;

5.15 does not result in windfall profits to any individual or group of individuals; and

5.16 serves a public purpose or is in the public interest.

5.2 In addition, the proposal shall be accompanied by :

5.21 an inventory of the Agency's assets, identifying those that are underutilized. If the proposed project is limited to one or more specific institutions or facilities, the inventory likewise may be limited to the assets contained at such institution or facility;

5.22 evidence that, in the case of a project involving real property, the Division of Capital Planning and Operations has been notified and given a copy of the inventory;

5.23 evidence that the executive office within which the proposing Agency is located (or the Board of Regents for assets under its jurisdiction) has approved the Project;

5.24 all comments received as a result of the public comment process noted in section 4.0 herein.;

5.25 independent appraisals of the value of the Project assets;

5.26 detailed provisions for how the proposing agency plans to implement an open and competitive process for Project implementation pursuant to paragraph 5.3 herein;

5.27 a statement of the agency's plan to provide ongoing information required to assist the Board in its project monitoring responsibilities, as detailed in Section 6.0 herein.

5.3 If an approved Project includes the participation of a nongovernmental entity, that entity shall be selected through an open and competitive process. The selection process shall be detailed in the alternative procedures established by the Board.

5.4 A complete submission by an agency shall consist of 10 copies of all documents which shall be delivered to the Board in care of Office of Real Estate Management, DCPO, 1 Ashburton Place, 15th floor, Boston, MA 02108.

6.0 PROJECT MONITORING RESPONSIBILITIES

6.1 The Board shall monitor approved Projects by conducting the following activities:

6.12 periodic site visits;

6.13 review of annual independent audits submitted by the Agency for each Project; and

6.14 periodic review of the public purposes originally set forth in the proposal.

7.0 TRUSTS

7.1 The Board shall have the authority to authorize establishment of asset management trusts. Trusts shall be established by the state treasurer for each state agency with approved asset management projects and in accordance with the provisions of Section 8 of Chapter 150 of 1990, as modified by Section 10 of Chapter 5 of the Acts of 1991

8.0 TERMINATION

8.1 If the Board finds, as the result of the review process detailed in Section 6.0 herein, that the Project no longer serves the objectives stated in the proposal, the Board may terminate the Project provided that :

8.12 such termination takes place only after careful review of Project objectives, the Project's contribution to the public purpose, and is not arbitrary and capricious; and

8.13 such termination does not violate any terms and conditions in any agreements between parties to the Project.

9.0 SEVERABILITY

9.1 If any article, section, subsection, sentence, clause, or phrase, of these regulations is for any reason held to be unconstitutional, contrary to statute, in excess of the authority of the Board or otherwise inoperative, such decision shall not affect the validity of any other article, section, subsection, sentence, clause or phrase of these regulations.

10.0 AMENDMENTS TO THE REGULATIONS

10.1 These regulations may be amended by a binding vote of the Board.

These regulations are hereby adopted by the Board, on the _____ day of _____, 1991.

DISPOSITION PROCESS TO TRANSFER CONTROL AND MAINTENANCE OF LAND :

LEGISLATIVE AUTHORIZATION WILL BE NEEDED PURSUANT TO M.G.L. CH. 7, S. 40F1/2 PRIOR TO FINAL TRANSFER APPROVAL UNLESS AGENCY'S ENABLING LEGISLATION STATES OTHERWISE.

I. Declaration of surplus.

A. Chief executive authority of facility declares the property surplus to its needs.

B. Chief executive authority of agency reviews declaration and polls other facilities under his jurisdiction to determine if the property is surplus to their needs.

If declared Surplus, proceed to C.; if not, process ends.

C. Secretary of Executive Office reviews agency's declaration and polls other agencies under his jurisdiction to determine if the property is surplus to their needs.

If declared Surplus, proceed to II.; if not, DCPO reviews agency's proposal.

TIMETABLE: Executive Office controls this timetable.

II. DCPO polls all Executive Offices to determine if the property is surplus to their needs.

If declared Surplus, proceed to III., if not, DCPO reviews Executive Office's proposal.

III. DCPO polls the following local agencies/officials to determine if the property is surplus to their needs.

A. Board of Selectmen or City Council/Mayor.
B. County Commissioners.
C. Regional Planning Agency.
D. Local State Representative.
E. Local State Senator.

If declared Surplus, proceed to IV., if not, DCPO reviews Local Agency's proposal.

IV. If property is over two acres, DCPO schedules a reuse restriction hearing in municipality where property is located. If not over two acres, proceed to V.

V. DCPO commissions appraisal to determine fair market value of property.

VI. DCPO issues a Request for Proposals to the private sector for sale of this property.

VII. DCPO reviews the proposal and determines to accept or reject it.

VIII. DCPO drafts a deed, with appropriate restrictions, if any, for transfer of property.

IF THE PROPERTY IS OVER AN ACRE, PROCEED TO IX. AND X.; IF NOT, PROCEED TO XI.

IX. DCPO notifies local officials a minimum of 120 days prior to any transfer of property.

A. Notification may be shortened if either;
   1. All the local officials agree to shorten the notice upon the request of the deputy commissioner.
   2. The deputy commissioner certifies that an emergency exists.

X. DCPO conducts a public hearing in the municipality for the purpose of disclosing the conditions or reasons for the transaction 60 days prior to the transfer.

XI. Execution of deed.

Role of the Asset Management Board (AMB)

The 1990 legislation creating the AMB provides the mechanism for the creative re-use of state property (or other asset) without requiring the extensive and cumbersome surplusing process and the ratification of the legislature. The purpose of the AMB is to encourage state agencies to look at the management of their assets as an opportunity for revenue enhancement not previously realized. An asset may be real property, buildings and structures, leases, licenses, easements, air, water, and mineral rights, equipment, utilities, and professional and technical services.

The members of the AMB are the Secretary of Administration and Finance, who serves as Chairman, the Inspector General, and three members appointed by the Governor for terms of three years.

Under the AMB, assets which are not in productive use can be leased to other users upon approval by the AMB of a proposal presented by the controlling Agency. The AMB shall adopt Regulations to provide the procedures necessary to approve projects. In an effort to solicit proactive evaluation of its assets, an incentive to the controlling Agency is provided in the form of a Trust fund which may be established to receive not more than fifty percent of the proceeds accruing to the Agency as a result of the revenues produced by an approved asset management project.

Asset Management Board

Members	Phone Numbers
Peter Nessen Secretary & Chairman, AMB Executive Office of Administration and Finance State House, Room 373 Boston, MA 02133	work: 727-2040 fax: 727-1024
Joseph Barresi Inspector General Office of the Inspector General One Ashburton Place, Room 1311 Boston, MA 02108	work: 727-9140 fax: 723-3540
Brian T. Carty Partner Cooper & Lybrand One Post Office Square, 29th Floor Boston, MA 02109	work: 574-5249 fax: 451-1589 home: 489-0806
Michael Lipof President Property Research Group, Inc. United States Trust Company 40 Court Street Boston, MA 02108	work: 726-9781 fax: 726-7016
Fred Moavenzadeh Professor Massachusetts Institute of Technology 77 Massachusetts Avenue, Room 1-175 Cambridge, MA 02139	work: 253-7178 fax: 258-8168 home: 235-8018
JOHN MCCALLION TOM MCCOOGER HANDLES DIPCW ISSUES	
Asset Management Board c/o Office of Real Estate Management Donald B. Myers, Director ← NO LONGER W/ THE BOARD Division of Capital Planning and Operations One Ashburton Place Boston, MA 02108	work: 727-3957 fax: 727-5363

5/10/91

The Commonwealth of Massachusetts

ASSET MANAGEMENT BOARD

One Ashburton Place, Room 1610
Boston, MA 02108

PETER NESSEN, CHAIRMAN
JOSEPH R. BARRESI
BRIAN T. CARTY
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DONALD B. MYERS
Staff Director

MEMORANDUM

DATE: **May 16, 1991**

TO: **Peter Nessen, Chairman**

FROM: **Michael Lipof, Member** M.L.

RE: **Asset Management Board (AMB)**

As the Asset Management Board is moving ahead in defining its operation and role in the Administration's agenda, it has become clear to me that an effort by Governor Weld to acquaint and educate the Cabinet Secretaries to the functions of the AMB is timely. It has recently come to my attention that some of the agencies within these Secretariats are now working on privatization efforts of their own and are unaware of the AMB's existence. The active participation of the agencies is imperative to the success of the AMB.

I would like to discuss further with you some ideas for exploring the opportunities now possible through the AMB and to share, at the next meeting, some information that my research has recently uncovered.

ML:JMcC:lm

encl: "Role of the Asset Management Board"

xc: Joseph Barresi, Member
Brian T. Carty, Member
Fred Moavenzadeh, Member
John Moffit, Chief Secretary
Donald B. Myers, Director, OREM